Moral Firms?

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Building a new political economy requires transforming our markets, our institutions, and our policy and regulatory regimes. In this essay, I argue that it also requires transforming the purpose of the firm: from a singular focus on maximizing financial returns to the recognition that firms exist to support human flourishing, with profits merely a means to an end. I suggest that this transformation is already under way and indeed that it may help support fundamental change in the wider society, but that significant shifts in law, policy, and in the social and normative context are almost certainly essential if this new model is to become the norm.

Could "moral" firms not only thrive in today's intensely competitive world but also play a significant role in the struggle to build a new moral political economy? At first sight, the idea might seem preposterous. The world faces a series of potentially catastrophic problems – from climate change and massive biodiversity loss to accelerating inequality and continued racial exclusion – that are clearly public-goods problems, and that in many cases have been exacerbated by the ruthless push for profit that has characterized much of the last fifty years. In such a context, the idea that firms could be moral institutions committed to building a just and sustainable society might seem eccentric, if not disingenuous.

But the widespread acceptance of the idea that untrammeled greed should be the only motive for economic activity is a relatively recent phenomenon. For hundreds of years, capitalism – and capitalists – were held to high moral standards as a matter of course, and the pursuit of profit, unconstrained by a due regard for the community, was widely condemned.[1] In 1639, for example, a Mr. Robert Keaine, who "kept a shop in Boston," was fined £200 for charging "unreasonable" prices. John Cotton, the leading Puritan minister in Massachusetts at the time, preached against him, summarizing his "false principles" as including "that a man might sell as dear as he can, and buy as cheap as he can" and that "if a man lose by casualty of sea, etc., in some of his commodities, he may raise the price of the rest."[2]

As firms began to play an increasingly important role in European commercial life, the philosophers of the Enlightenment attempted to resolve the tension between morality and profit by proposing that the greedy businessperson might – paradoxically – increase the general good, *as long as firms competed fairly and honorably with each other*. Adam Smith and his colleagues suggested that replacing the imper-

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ative to pursue honor with the imperative to pursue material gain could only make society better off, and in doing so transformed greed from a vice into a virtue that could enrich the entire society.[3] But this solution was *not* taken to release businesspeople from the need to have a strong sense of personal morality. Smith's *Theory of Moral Sentiments*, for example, insists that businesspeople need to pay great attention to matters of personal ethics, and indeed that society might not survive if they do not.

The idea that business had to be constrained by ethical precepts and a sense of responsibility to the broader society survived well into the twentieth century. Edwin Gay, the first dean of the Harvard Business School, serving from 1908 to 1919, announced that the school's purpose was to educate leaders who would "make a decent profit, decently," and in the thirty years following World War II, most large firms claimed to be managing their firms for the benefit of all their "stakeholders."[4] As late as 1981, the Business Roundtable – an organization composed of the CEOs of many of the largest and most powerful American corporations – issued a statement that said, in part:

> Business and society have a symbiotic relationship: The long-term viability of the corporation depends upon its responsibility to the society of which it is a part. And the well-being of society depends upon profitable and responsible business enterprises.[5]

Indeed, Milton Friedman's famous suggestion that the "social responsibility of business is to increase its profits" is first and foremost a *moral* injunction, rooted in the belief that free markets can be a source of immense economic prosperity and individual freedom. From this perspective, to suggest that managers do anything other than maximize profits is to invite them both to abandon their duties as agents of their investors and to make society poorer and less free.[6]

But pursuing profits at any cost only maximizes economic prosperity when markets are perfectly competitive, or, among other conditions, when "externalities" such as climate change are appropriately priced and when everyone can freely compete in every market.[7] Markets only maximize social well-being when they support – or at least do not destroy – the health of the society and of the public institutions on which they rely. In a world in which many firms feel free to fund climate denial, to lobby aggressively to rewrite the rules of the competitive game in their own favor, and to tolerate working conditions that systematically atrophy the psychological and cognitive skills required to sustain democracy, there is no reason to believe that maximizing profits maximizes social welfare or individual freedom, or even that it meets the wishes of investors.[8]

In this context, there has been an explosion of interest in the old idea that firms should be "purpose driven": that making money should be viewed as a means to an end, not an end in itself; and that the goal of the firm should be not to maximize financial returns but to support the flourishing of the society in which it is embedded. In August 2019, for example, the Business Roundtable released a statement redefining the purpose of the corporation as "to promote an economy that serves all Americans."[9]

"Purpose" is fashionable – and global. One survey found that 40 percent of employees believed that the firms they worked for had embraced a purpose beyond profit.[10] Another poll, drawing on more than thirty-six thousand interviews across twenty-eight countries, found that "Societal Leadership is now a core function of business" and that "60% of employees want their CEO to speak out on controversial issues they care about."[11] Discussion of "stakeholders" and "corporate social responsibility" has boomed, as has widespread condemnation of this trend as "woke" capitalism – surely a sign that it is starting to have real effects.[12]

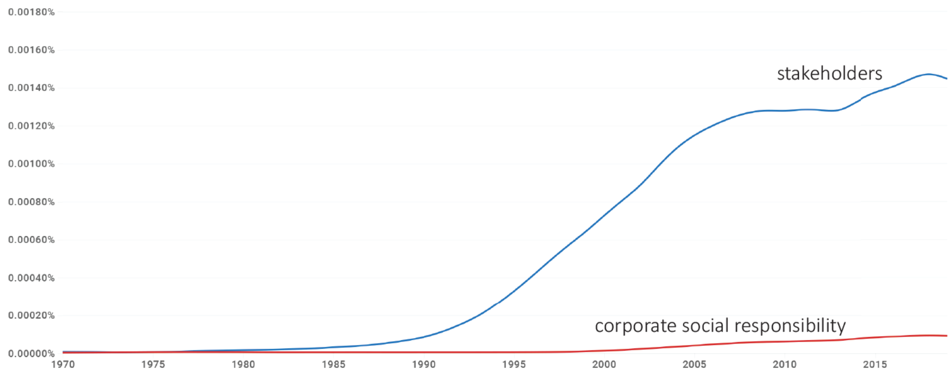
Have firms changed their behavior? Some of this activity is clearly posturing, but as political scientist Richard Locke and colleagues' discussion in this issue of *Dædalus* of the very different ways in which Tyson Foods and Sanderson Farms responded to the COVID-19 pandemic suggests, a significant number of firms are choosing to act in increasingly prosocial ways.[13]

Consider, for example, the case of Erik Osmundsen, who gave up a career in private equity to become the CEO of Norsk Gjenvinning (NG), a Norwegian waste handling company. Osmundsen took the job because he had become passionately committed to action against climate change, and because he believed that building a "circular economy" – that is, transforming trash from a nuisance to be disposed of into a source of raw materials – could reduce global greenhouse gas emissions by billions of tons.[14] On taking the job, he discovered that the industry was cutting costs by dumping waste illegally, and announced that NG was going to do things differently: that it was going to conform to the law, to invest heavily in recycling, and to raise prices to cover the costs of doing so. This did not initially go down well. Half of his senior staff quit. So did many of his customers. His competitors denounced him for "bringing the industry into disrepute" and he and his family required police protection.

Fortunately, NG's investors agreed that the new strategy might create long-term competitive advantage. Some customers were willing to stick with NG to protect their brands. Those employees who remained loved the idea of working for a company that was trying to transform the industry, and there was an explosion of innovation inside the firm that significantly reduced costs.[15] Today, NG is a leader in recycling technology and one of the largest recycling firms in Scandinavia.

Corporate leaders have often assumed that treating profit as a means to an end rather than a means in itself inevitably reduces profits. But there is no evidence that – on average – pursuing prosocial goals reduces performance. In fact, more recent work using better measures of prosocial commitment suggests that adopting prosocial goals is often correlated with superior financial performance.[16]

Figure 1
Google Books Ngram of the Frequency of Use of "Stakeholders" and "Corporate Social Responsibility" in Printed Texts, 1970–2019



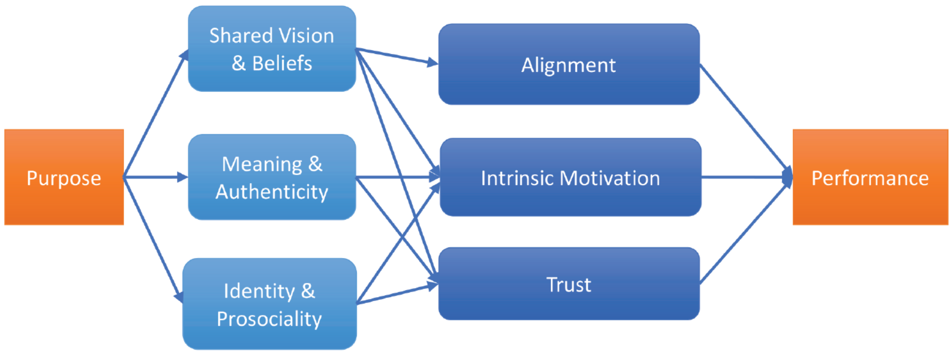
Source: Google Books Ngram Viewer, "Stakeholders" and "Corporate Social Responsibility" (case-insensitive), created May 26, 2022.

At first sight, this might seem paradoxical. How can raising wages above the competitive norm or switching to renewable energy when coal remains a cheaper alternative increase profitability? One answer is that the authentic embrace of purpose increases strategic alignment and levels of intrinsic motivation and trust across the organization, driving significant increases in productivity and creativity.[17]

High levels of strategic alignment and trust – coupled with the wider worldview that often comes with the embrace of a prosocial purpose – in turn often make it much easier for firms not only to identify the opportunities being opened by the need to decarbonize the world's economy and rebuild its societies, but also to implement the sweeping organizational and strategic changes required to take advantage of them.[18]

This should not be taken to imply that adopting a prosocial purpose is the royal road to riches. As Osmundsen's experience at NG suggests, successfully addressing problems like global warming often requires drastically rethinking the purpose of the firm and taking significant short-term hits to profitability to persuade employees, customers, and regulators that the purpose is authentic. In an environment in which many investors value short-term returns above long-term promises, becoming a genuinely purpose-driven firm is not for the faint of heart. This raises two questions. Are there ways in which it could be made easier? And if it will always be an uphill battle, is it worth attempting?

Figure 2
From Purpose to Performance



Source: Figure by the author. Each of the arrows summarizes a significant academic literature. See Rebecca Henderson, "Innovation in the 21st Century: Architectural Change, Purpose, and the Challenges of Our Time," *Management Science* 67 (9) (2021): 5301–5967, https://doi.org/10.1287/mnsc.2020.3746.

How can firms be persuaded – or prodded – to become more purpose driven? One critical step is to change the metrics used to measure and control firms. Without material, auditable, and replicable measures of the firm's environmental and social impacts, it will be impossible for employees, customers, investors, or regulators to hold purpose-driven firms accountable. Fortunately, accounting is undergoing a revolution. Both the Securities and Exchange Commission (SEC), the body that regulates U.S. accounting standards, and the International Accounting Standards Board (IASB), the body that handles global financial standards, are considering requiring that, in addition to classical financial measures, firms also report environmental, social, and governance (ESG) metrics.[19] Developing these metrics will not be easy or cheap, but investors are increasingly demanding that firms begin the process of reporting them.

Another important step is to make clear that most firms have no legal duty to maximize shareholder value. Many managers – particularly in the Anglo-American sphere – believe that their fiduciary duty requires them to maximize investor returns. This is rarely the case. Nowhere in the world are firms legally required to maximize investor returns, and in general, it is entirely legal for publicly traded firms to embrace prosocial goals.[20]

Under Delaware law, for example, directors have fiduciary duties of care, loyalty, and good faith to both the corporation *and* its shareholders. This means that directors can – and should – sometimes make decisions that do not maximize shareholder value in the short term to pursue long-term success. U.S. directors facing hostile takeover bids do this routinely, turning down offers that value the firm at significantly more than its current stock price in the belief that the takeover is not in the company's long-term interests. It is probably illegal to make a business decision that will certainly destroy long-term shareholder value, but except in a few tightly defined situations – such as when so-called Revlon duties are invoked, requiring a board to attempt to get the best possible price for shareholders during a company's sale – directors are protected by the business judgment rule and are free to embrace a prosocial purpose if they can make a convincing case that it will increase long-term profitability.[21]

Nonetheless, in nearly every jurisdiction, investors remain very much in control of the company, and their ability to replace directors at will makes many managers reluctant to commit to a prosocial purpose. Improving the ability to measure both the presence and the impact of such a purpose would certainly help, as would changing the rules that govern activist shareholders to make their actions more transparent, increasing the holding period for long-term capital gains tax, and establishing a modest financial transaction tax.[22] But changing corporate law could also make a significant difference.

One option is to require managers to consider the well-being of other stakeholders as they make decisions. For example, Principle B of the new UK Corporate Governance Code states that "the board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned."[23] The British Academy project on the Future of the Corporation suggests that company directors should be required to establish a company purpose, to act in ways likely to promote fulfilment of that purpose, and to consider the consequences of any decision for the interests of both shareholders and stakeholders.[24]

Another possibility is to revise incorporation laws to encourage, or even require, companies to become "benefit corporations." Benefit corporations bind themselves to create "public benefit." They must publish a strategy outlining just how they plan to do this and produce an audited report every year detailing their progress toward their goals. Board members are required to consider the public interest in every decision they make.[25]

While these kinds of changes might seem relatively toothless since they leave investors in control of the firm, they could play an important role by reassuring managers that they cannot be legally penalized for considering the needs of other stakeholders, and by changing the nature of the conversation within the company and between the company and its investors. The widespread belief that a focus on the creation of social value will reduce profitability is as much an ideological or cultural artifact as it is a reasoned judgment about long-term strategy. Forcing firms to actively confront the question of whether taking a broader perspective might not only be the morally appropriate thing to do, but could actually be in the long-term interest of the firm could play an important role in driving the shifts in conversation and attention that are fundamental to long-term systemic change.

Another possibility is to reduce the power of investors by vesting control in employees or customers, or in a trust or foundation, relying on loans or operating funds for capital. Mondragon, for example, is one of Spain's largest employers, with more than €12 billion in revenue and a wide-ranging global presence. It is also wholly owned by its eighty-one thousand employees.[26] Novo Nordisk, a pharmaceutical firm whose controlling shareholder is a foundation dedicated to creating long-term social good, is one of the most innovative and profitable firms in the pharmaceutical industry.[27] Reducing the legal and regulatory hurdles that make these alternative governance forms relatively hard to create would support a wave of experimentation that could have profoundly far-reaching effects.

A complementary approach could be to make *investors* purpose driven. This might seem even more eccentric than the idea that firms might become moral entities, but many of the world's largest investors and asset owners are increasingly aware that systemic risks like climate change present a significant threat to long-term financial returns. ESG funds captured a record $51.1 billion of net new money from investors in 2020, more than double the prior year.[28] In his 2022 annual letter to CEOs, Larry Fink, the CEO of Blackrock, the world's largest asset management firm, explained: "We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients."[29] Seventy-five percent of investors now claim that climate change is central to or a significant factor in their investment policy, and climate-aware investors have recently scored some successes, including the addition of three new board members to Exxon's board.[30]

Another important move would be to modify the fiduciary responsibilities of asset managers. Many pensioners – the owners of a large fraction of the world's actively managed capital – have both much longer time horizons than their asset managers and a strong interest in ensuring that firms behave ethically and sustainably. One possibility, as Leo Strine, retired Chief Justice of the Delaware Supreme Court, suggests, is to require that institutional investors consider their ultimate beneficiaries' specific investment objectives and horizons as part of their fiduciary duties, and to explain "how their voting policies and other stewardship practices ensure the faithful discharge of their new fiduciary duties and take into account the new information reported by large companies on employee, environmental, social and governance matters."[31]

While in many jurisdictions the kinds of changes I have outlined above are already making a difference, persuading firms to focus as much on the creation of social value as on the creation of financial value will almost certainly require not only significant changes in metrics, corporate law, and investor behavior, but also fundamental change in the norms and practices of the business community and of the broader society.

In Japan, for example, following World War II, the business community and the society at large explicitly embraced a model of capitalism that stressed the well-being of employees, a commitment to the long term, close engagement with suppliers, and an almost obsessive focus on the customer. These practices were complemented by tight relationships with a few large investors who generally played no formal role in the firm's governance. Japanese firms raised the bulk of their capital from banks and, in most firms, the board of directors was staffed exclusively by company insiders and chaired by the CEO. While many firms were publicly listed, and in principle subject to fiduciary duties very similar to those constraining their U.S. counterparts, they were protected from the threat of takeover by a system of extensive cross-holdings. At their peak in the early 1990s, these holdings accounted for around half of the value of all Japanese equities. This approach enabled Japanese firms to conquer the world's economy with innovative, low-cost products of unsurpassed quality. Between 1960 and 1995, Japan's GDP grew at an extraordinary rate, an "economic miracle" that made Japan the world's second-largest economy.[32]

In Germany, a system similarly dedicated to the well-being of the entire community has generated strong economic returns, large investments in environmental protection, and relatively low levels of inequality. German corporate law requires active "codetermination" between employees, investors, and managers, requiring, for example, the presence of employee representatives on the boards of companies over a certain size. But the nation's commitment to stakeholder well-being has historically also been upheld by a strong social consensus that it was appropriate to focus on stakeholder welfare, by investors who have had deep experience with its success and who were committed to its continuance, and by strong pressure from a powerful labor movement and a capable, highly respected federal government.[33]

Could these kinds of changes take hold in a world dominated by Anglo-American models of capitalism? At a time when corporations seem intent on sacrificing both democracy and the health of the planet to the pursuit of profit, could purpose-driven firms really be allies in the struggle to build a new moral political economy? Many thoughtful observers believe that modern capitalism has an inherently corrosive effect on the moral capital of the societies in which it is embedded, and in the United States, some corporations have already experienced significant backlash against their supposed surrender to "woke" ideologies.[34]

Of course, the implementation of an appropriate suite of policies would make a shift to purpose significantly easier. As several of the other essays in this volume suggest, building a genuinely moral economy will require the development of much stronger forms of employee representation, policies designed to support human social flourishing and to protect the environment, and fundamentally rethinking the nature of our institutions.[35] The most effective way to persuade firms to decarbonize, for example, is through regulations or the use of market-based mechanisms – such as climate taxes – that make it expensive to burn fossil fuels or emit greenhouse gases.[36] But it is a mistake to let firms off the hook while we wait for this kind of transformative political change. Firms are among the most powerful institutions in the world, and there are – alas – many jurisdictions in which these kinds of policy changes are unlikely to be enacted or enforced. Building a moral economy also requires continuing to insist that firms think of themselves as moral entities whose fundamental commitment must be to the well-being of our society.

Active private sector cooperation, for example, could greatly accelerate the process of implementing the new regulatory and policy regimes we need. In the case of climate change, fully transitioning the electric power grid in the United States to renewable or recyclable energy will require a host of systemic investments – from control systems to power lines to storage systems – and hundreds of regulatory approvals. Even when prices are aligned and consumers are excited, technological development and diffusion take time. But firms willing to take the risks necessary to introduce new products and services can greatly assist the process.[37] Effectively addressing inequality and inequity is also much easier in partnership with firms who understand their mission as being more than maximizing profits. Solving the "good jobs" problem will require not only building a stronger voice for employees but also deep strategic collaboration between firms and local governments.[38] Purpose-driven firms are much more likely to be interested in these kinds of collaborations, not only because they are morally committed to reducing inequality, but also because they will benefit significantly if their competitors can be forced to behave better.

Purpose-driven firms are also much more likely to support the enactment of effective policy. Those firms that have made ambitious commitments to reduce greenhouse gas emissions, for example, will be significantly better off if governments can be persuaded to enact binding carbon regulation. Several of these firms have become visible advocates for climate regulation.[39] Some purpose-driven firms also actively support increases in the minimum wage and in public spending on local education and health care.[40]

Authentically moral firms might also help build the massive social and political movements needed to create a genuinely moral political economy. For most of the world's population, the firm they work for is the single institution they trust the most.[41] It is where many people spend the vast majority of their working hours, and often the only place where they meet people whose views differ significantly from their own. Sustained experience in a setting in which many people attempt to shape their lives according to prosocial goals, and in which people are treated with dignity and respect and given real autonomy over their work lives, might prove to be breeding grounds for active citizens.[42]

Last but not least, purpose-driven firms could become active collaborators in the process of building effective democracies. While political engagement by firms is always a cause for concern, firms in many countries are already knee-deep in political activity, often in ways designed to increase profits rather than to increase social well-being. Purpose-driven firms that push for systemic reform and transparency around political engagement might foster a conversation that helps to change norms around political engagement. Very few businesspeople would defend the use of child labor, no matter how profitable it might be. A world in which burning fossil fuels and actively corrupting the political process are similarly unacceptable is surely not unthinkable.

The good news is that business has a strong collective case for solving the great public goods problems of our time. Destabilizing the climate, destroying the biosphere, and fracturing or displacing human societies will significantly reduce rates of economic growth.[43] An increasingly angry populism is likely to lead to the embrace of authoritarianism and – with it – of crony capitalism. Many firms understand that neither outcome is good for business, and they are increasingly building cooperative coalitions in response.[44]

Consider, for example, the problem of deforestation, the source of as much as 10 percent of the world's greenhouse gas emissions. Continued deforestation threatens both the brands and the supply chains of the world's consumer goods companies. But the early, purpose-driven commitments of a number of firms, including Unilever, Mars, and Coca-Cola, persuaded the buyers of more than 65 percent of the world's globally traded palm oil to commit to purchasing sustainably grown palm, paper, beef, and soy. Working with the large Brazilian food companies and the Brazilian government, they were able – before the advent of the Bolsonaro administration – to dramatically scale back deforestation in the Amazon.[45] There are more than two hundred such cooperative projects currently underway, from halting labor abuse in the textile industry and global fashion supply chain to developing low carbon technologies to make aviation fuel, cement, and steel.[46] These efforts have the potential to attract both investor and regulatory attention, provoking the development of formal sanctions for those firms that choose not to participate, and potentially tipping entire industries into patterns of better social or environmental performance.

Taken together, these efforts could help create a virtuous circle in which purpose-driven firms demonstrate that acting for the common good increases profitability (and social well-being), potentially persuading other firms to join them, supporting governments in enacting policies that might lock good behavior into place, and perhaps even helping to catalyze the social and political movement we need to build a truly just and sustainable society.

Transitioning to a world in which every firm embraces – and acts on – the idea that firms exist, in business scholar Colin Mayer's elegant formulation, "to solve [public] problems profitably" will require exploring precisely how firms can find the right balance between a commitment to investors and a commitment to the well-being of the broader society.[47] This will take time. It will be accelerated by the kinds of social and political change advocated by so many that work in this space: by the revitalization of democracy, including a renewed commitment to capable, democratically accountable government, and by the emergence of some kind of organized voice for employees. But it will – I believe – also be driven by those business leaders at every level who are only too aware of the damage that our current conception of the firm is doing, and who are even now putting themselves on the line to build a truly moral economy.

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