Reforming Business for the 21st Century

A Framework for the
Future of the Corporation

The British Academy
Future of the Corporation

Preface

Professor Sir David Cannadine

As an historian, the future may not be natural territory. Yet the future of the corporation starts with its history, and the corporation has a history of being a remarkable instrument for bringing people together to commit to a collective endeavour.

This report from the British Academy sets out a new framework for business in the 21st century, drawing on the finest minds in the UK and beyond. It is the first in our series on the Future of the Corporation; a programme which aims to contribute to redefining business in the 21st century and building trust between business and society.

The ambition of the Future of the Corporation programme reflects not only the scale of the issues it addresses but also its method to answer them. Far from being a narrow look at the corporation, it draws on disciplines across the Humanities and Social Sciences – demonstrating the value of these subjects in understanding the past, making sense of the present and extrapolating to the future.

It also exploits the British Academy's convening power in the field of business and policy to engage leading thinkers in business and government in ensuring the relevance of our research for business practice and public policy.

This work is vital now because of people's concerns about rising inequality, increasing globalisation, declining trust and the impact that new technologies will have on employment. Business and government have sought different solutions to these challenges, but alone these solutions have been found wanting.

Through this programme, The British Academy has started a debate on the way in which business will be conceived, managed and regulated over the coming decades. We are committed to this dialogue, but we cannot do it alone. It will be a hard road that requires leadership, audacity and clear-sightedness about the challenges ahead. So we call on all business leaders, politicians, civil society actors and fellow academics to take note and join us in collectively working out the solutions.

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Foreword

A radical reformulation of the concept of the firm

The Future of the Corporation is one of the most ambitious programmes of research to have been undertaken to date on the current state and future prospects of business. Its remit is to consider the implications of economic, environmental, political and social challenges, and scientific and technological opportunities for the future development of business. It is organised by the British Academy, the UK's national body for the humanities and the social sciences.

31 academics from the humanities and social sciences have been participating in the first stage of the programme. Guidance from 25 business leaders has grounded this research in practice. What emerges is a profoundly novel and insightful perspective on business that lays the foundation for a radical reformulation of the concept of the firm. While the 13 projects were undertaken independently by people from a diverse range of academic disciplines from institutions in different parts of the world, the conclusions of their papers demonstrate a consistency of thought and a coherent view of how business should adapt and respond to the challenges and opportunities it faces.

What this report seeks to do is draw together the substantial body of knowledge and insights that the thirteen research projects provide on the current challenges that confront businesses, governments and societies around the world. While setting out key principles for the future of the corporation, the report is primarily diagnostic in identifying the nature and source of the problems rather than prescriptive in proposing detailed policy recommendations. These will be the focus of phase two of the research programme, which will start in 2019.

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Executive summary

- Corporations were originally established with clear public purposes. It is only over the last half century that corporate purpose has come to be equated solely with profit. This has been damaging for corporations' role in society, trust in business and the impact that business has had on the environment, inequality and social cohesion. In addition, globalisation and technological advances are exacerbating problems of regulatory lag.

- Together, these issues are intensifying the need for a reconceptualisation of the corporation around purpose. The Future of the Corporation programme represents the most comprehensive attempt to date to provide this reconceptualisation. Our research suggests a need to develop a new framework for the corporation around three interconnected principles.

- The first is well-defined and aligned **purposes**. Corporate purpose is the reason why a corporation exists, what it seeks to do and what it aspires to become. Profit is a product of the corporate purpose. It is not the corporate purpose. In some, but by no means all cases, corporate purposes should include public purposes that relate to the firm's wider contribution to public interests and societal goals.

- The second principle is a commitment to **trustworthiness**. When corporations commit to purposes, they commit to the various parties that are involved in the delivery of those purposes and vice-versa. This creates reciprocal benefits for the firm, its stakeholders and society. These arrangements rely on relations of trust.

- The third principle is embedding an enabling **culture**. The trustworthiness of an organisation is reliant on clearly articulated values that are adopted consistently in the culture of the corporation.

- Achieving a shift to this new framework will require coordinated action using five levers. First is **ownership**. Corporate ownership is currently equated with shareholders. Instead it should be associated with defining and implementing corporate purpose. The rights and responsibilities associated with corporate purpose should replace property right views of ownership. Different types of owners are suited to different types of corporate purposes and activities. This points to the need for diversity in corporate ownership.

- The second lever is corporate governance. **Corporate governance** is currently associated with aligning the interests of management and shareholders. Instead it should be linked to the implementation of corporate purposes. Boards cannot control some of the largest risks relating to globalisation, the environment and technology. New performance measures are needed for executives to ensure conformity of corporations' activities and investments with their purposes.

- The third lever is **regulation**. The notion that competition, regulation and taxation are sufficient to align the interests of business with society is no longer tenable. Technology is intensifying the problem of regulatory lag. One concrete proposal in this regard is to promote 'forward compliance'. More generally, a fundamental overhaul of regulation is required that encourages companies which perform significant social functions to incorporate public purposes in their corporate purposes.

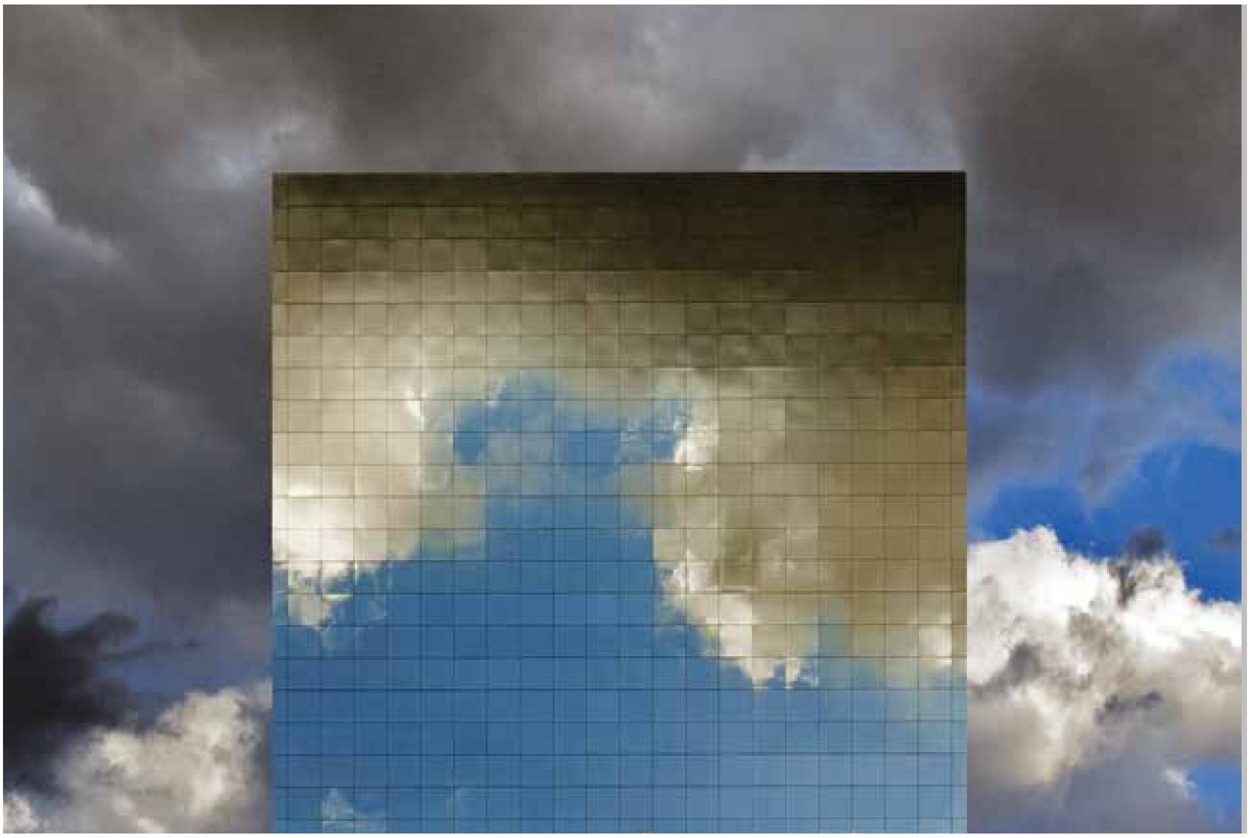
- Fourth is **taxation**. Globalisation has eroded the corporate tax base by allowing corporations to arbitrage tax domiciles and transfer liabilities to lowest tax jurisdictions. Our research paper identifies and debates the main reforms that are currently discussed. However, none of these are without their problems, pointing to the need for a closer association of corporate with public purposes in determination of fair levels of taxation.

- The final lever is **investment**. Public as well as private investment is required to deliver large-scale, long-term infrastructure investments. Attempts to achieve this through privatisations, public-private partnerships and private finance initiatives have often been disappointing. It is in precisely these areas, where corporations perform important public and social functions, that private and public purposes need to be aligned through the adoption of public purposes in corporate charters and articles of association.

- Together these five levers of ownership, governance, regulation, taxation and investment offer the opportunity of promoting corporate and public purposes around trustworthy organisations with enabling cultures of integrity.

Below

There is a need for a reconceptualisation of the corporation around three interconnected principles: purpose, trustworthiness and culture.



Introduction

The bond between the corporation and its public purpose has waxed and waned since corporations were first established nearly two millennia ago.

This has happened in response to socio-economic and geopolitical shifts, but the corporation's foundations remained embedded in delivering public purposes alongside commercial functions. It is only over the last half-century that the sharp intensification of the profit motive has occurred. It came as markets for corporate control emerged to fill the vacuum in corporate governance created by growing dispersion of ownership.

In 1962, Milton Friedman set out a framework for business in which he described the social responsibility of businesses as being to increase profits so long as they stay within the rules of the game. It was a powerful and influential proposition that established the conventional framework for business around the world. However, it has serious deficiencies and is no longer tenable as a framework for business in the 21st century. It has been the source of growing disaffection with business, its environmental, social and political problems, and the erosion of trust in it. Those problems will intensify in the future as technological advances risk exacerbating social detriments as well as benefits of corporations, and public policy responses lag increasingly far behind innovations.

There is an urgent need for reform

In response, the British Academy has brought together leading academics and business stakeholders under an ambitious programme to redefine the future of business in the 21st century. The programme is grounded in an academic research and steered by practical insights from the business community. It began in 2016 when a Steering Group and a Corporate Advisory Group of business leaders were established to advise the programme. A set of interviews with business leaders was commissioned and published as *"The Voice of Business"* in 2017 and this, together with a series of events, assisted in the design of the phase one research around ten specific themes: history, purpose, trust, culture, technology, law, regulation and taxation, corporate governance, ownership, investment and social benefits. Thirteen groups of academics were then commissioned to explore these themes drawing on the best available existing evidence. They reviewed existing literatures, analysed them and developed new thinking on the themes. The thirteen papers are listed at the end of the report and many of them will be published in a special edition of the Journal of the British Academy. This report collects the findings together in a single narrative and draws out initial conclusions and policy implications which will inform the next stage of the programme.

What the research and the subsequent synthesis has found is that the proposition that the purpose of business is to increase its profit, with the rules of the game preventing excesses, is not sufficient for the 21st century. The new framework for the corporation we present in this report calls for a reinterpretation and integration of three principles: a redefining of corporate purpose that is distinct from shareholder returns, an establishment of trustworthiness founded on norms of integrity, and the embedding of a culture in organisations that enables both.

Corporate purposes are the reasons a corporation is created and exists, what it seeks to do and what it aspires to become. They reflect the contribution it wishes to make in furthering the interests of its customers, communities and societies and they are the basis on which relations of trust are created in business. They are distinct from the consequential implications for the corporation's profitability and shareholder returns.

All corporate purposes should be intrinsic in the sense that they are core to the business and not just driven by shareholder interests. A close alignment and observance of public interests in corporate purpose is particularly relevant to some companies that perform important social functions, such as utilities.

Trust relations in business are created on the basis of corporate purposes. When corporations commit to corporate purposes, they commit to the various parties that are involved in their delivery and vice-versa. This creates reciprocal benefits for the firm, its stakeholders and society at large.

The trustworthiness of an organisation is an attribute dependent on cultural norms that promote high levels of integrity. It is reliant on clearly articulated values that are adopted consistently throughout the organisation. Ethical motivations of owners, boards, managers and employees are necessary to build trustworthiness in relation to customers and other stakeholders. There is a particular duty on corporations to demonstrate trustworthiness where there is a dependency of others on it, or incapacity to avoid the consequences of its violation.

Trustworthy behaviour and corporate purpose must be enabled by a **culture** of honesty, integrity and other-regarding interests within the firm. It should be promoted by the leadership and embedded consistently throughout the corporation. It may be supported by external regulatory requirements but the ability of external parties to provide effective regulation is being eroded, particularly by the accelerating pace of technological advances.

We examine five levers that government and business may use to bring about the shift towards the new framework: ownership, corporate governance, regulation, taxation and investment.

Owners of corporations have a profound influence on the promotion of corporate purposes. However, they have not exercised that influence sufficiently. The ownership of corporations is currently associated with shareholdings and the attribution of shareholder rights with property rights of shareholdings. Instead, ownership should primarily be related to the formulation and implementation of corporate purposes.

Corporate governance is at present primarily concerned with aligning managerial interests with those of shareholders. But it should be recognised as the means by which corporate purposes are implemented by management in the organisation. The particular form that corporate governance takes will therefore be specific to the nature of the firm's corporate purposes and the particular requirements to deliver them.

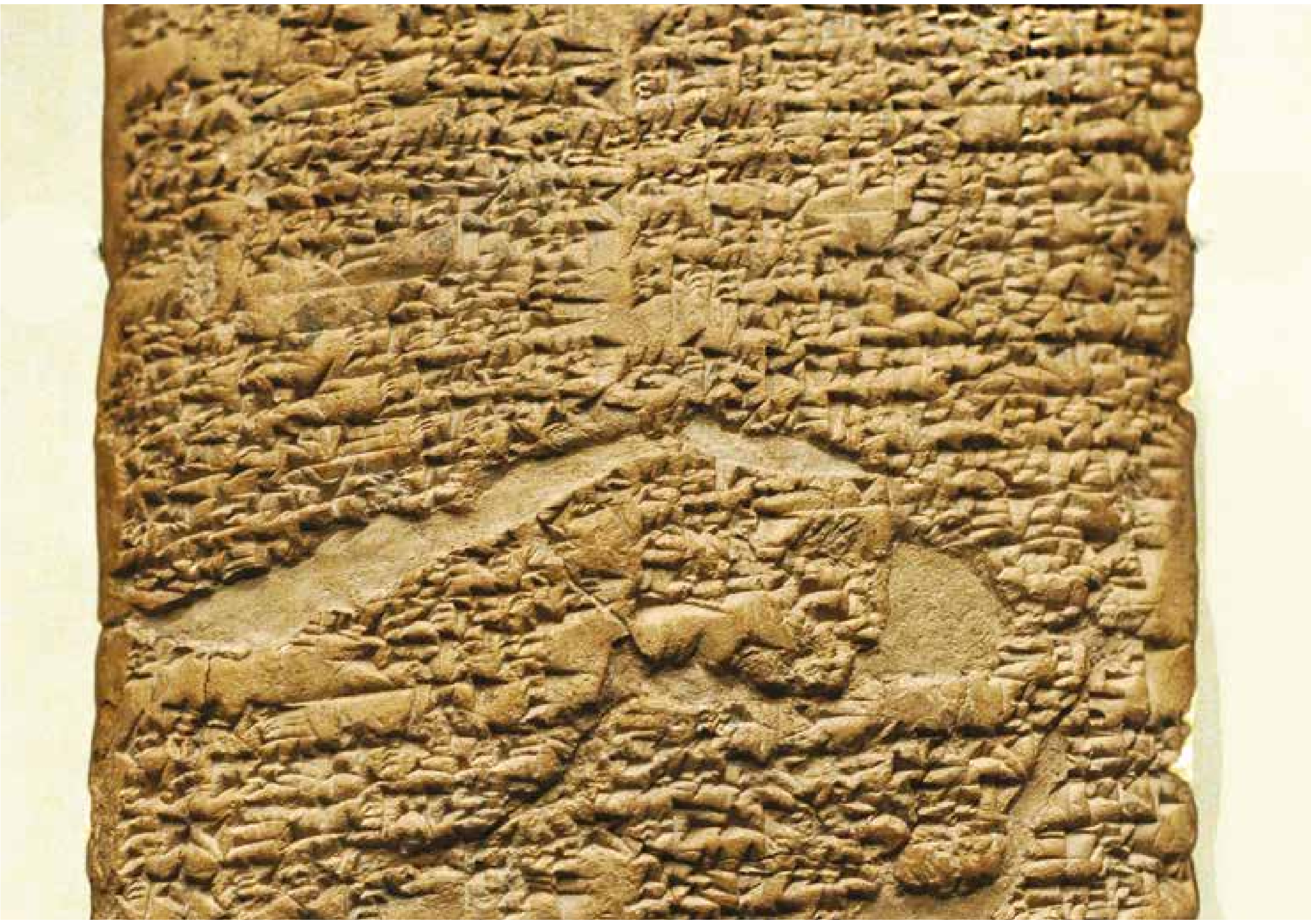
The notion that **regulation** and taxation are sufficient to align the interests of business with society is no longer tenable. Technological advances are lengthening the lag of regulation behind the innovatory processes and products that corporations are adopting. This is intensifying the failure of policy to correct the detriments created by corporations motivated predominantly by a profit purpose. Instead regulation should be seeking to align corporate with public purposes in those organisations and circumstances where it is most relevant because of the social function performed by corporations.

Globalisation is intensifying the inability of nation states to use **corporate taxation** as a source of public revenue. Attempts to rectify this through alterations to the structure of corporate taxation have not been successful to date. This reflects a failure of corporations to recognise and respond to their dependence on societies and nation states through including payment of fair shares of taxes in their corporate purposes.

The provision of large scale, long-term **investment** involves the participation of government as well as the private sector. The performance of privatisations and partnerships between the public and private sector in their delivery has often been disappointing. It is in precisely these areas where corporations are performing significant public and social functions that corporate purposes should be aligned with public purposes by incorporating the latter in the charters and articles of association of the former.

The five policy levers of ownership, governance, regulation, taxation and investment offer the opportunity of reconceptualising corporations of the 21st century within a framework of defined corporate purposes and a commitment to trustworthiness enabled by corporate culture.

This report makes the case for change in part 1 and elaborates on the three principles of the new framework in part 2. Part 3 examines each of the five levers for change before concluding and describing the next steps for the Future of the Corporation programme.



1: The case for change

There is a strong and growing ambition to reconsider and reinterpret the nature of the corporation, especially in terms of enabling better alignment between business and public interests. History tells us there is nothing radical in this and demonstrates that it has been commonplace in many manifestations of the corporate form.[1]

Tensions caused by technology and evolving corporate forms are not new either. Technology is once again the driving force behind the need for an evolution in the corporate form. Increasing technological change is pushing corporations to adapt business models and management practices in order to survive. But institutions and regulations are adapting too slowly and the situation calls for a robust new framework for business that recognises the importance of both corporate and public interests.[2]

Above

The Code of Hammurabi in Babylonia represented the first written attempt to regulate commercial matters.

1 Davoudi, L., McKenna, C. & Olegario, R. (2018), 'The Historical Role of the Corporation in Society', *Journal of the British Academy*, 6(s1)

2 Hsieh, N., Meyer, M., Rodin, D. & van't Klooster, J. (2018), 'The Social Purpose of Corporations: A Literature Review and Research Agenda', *Pending Publication*

A basis in history for corporate purpose

Throughout its 4,000-year history from the Code of Hammurabi in Babylonia, through the Roman Republic to the East India Company and the Industrial Revolution, business enterprise has been motivated by a strong element of public purpose.[3] The corporation was established In Roman Law to perform public functions of minting coins, collecting taxes, looking after public buildings and undertaking public works. It was then used in the governance of municipalities in Europe, the creation of the first universities and the establishment of the Roman Catholic Church.

The corporation was also the basis of the emergence of the merchant trading companies, most notably the East India Company, and then the companies that built the railroads and canals. With freedom of incorporation in the 19th century came the private company, which was the backbone of the rise of manufacturing industry, service companies and transnational corporations.

It is only over the last 60 years that the drive to equate corporate purpose with increasing profit has become so acute. This has resulted from the emergence of markets in corporate control – the takeover market — in the 1950s and more recently hedge fund activism. It was encapsulated in what became the conventional conceptualisation of the corporation in modern times – the Friedman Doctrine, as first described in Milton Friedman's book Capitalism and Freedom in 1962 — that *"the one and only social responsibility of business is to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game"*.[4] It is the basis of business education and practice and the formulation of laws and regulation towards business around the world.

The reason why this happened was the changing nature of ownership of corporations that occurred through the 20th century and the consequence of this for their governance. After freedom of incorporation was first introduced in the 19th century, families and founders were initially the owners of predominantly private companies. However, during the first half of the 20th century ownership became increasingly dispersed in the hands of first individual and then institutional shareholders, such as life insurance companies, pension funds and mutual funds.

This created a problem of the separation of ownership of companies from their management and the concern described by Berle and Means that large corporations were increasingly being run by management that was accountable to no one.[5] The response was a focus on how to align the interests of management with those of shareholders through incentives and markets for corporate control.

It is at this point that our research suggests the nature of the corporation erred.[6] While it was right to be concerned about the lack of accountability of management, it was wrong to see its resolution in control by one party to the firm. The reason why this happened was that the rights of shareholders were equated with the property rights of owners. Shareholders bore the risks and rewards of the success and failure of business and so had corresponding rights to control it.

But shareholders are not in many cases owners in any meaningful sense of the word and do not aspire to act as owners. This misconception and preoccupation with one single party to the firm rather than a wider constituency has been the cause of mounting

3 This section primarily summarises findings from Davoudi, L., McKenna, C. & Olegario, R. (2018), 'The Historical Role of the Corporation in Society', *Journal of the British Academy*, 6(s1)

4 Friedman, M. (1962) Capitalism and Freedom, The University of Chicago Press

5 Berle, A. and Means, G. (1932), The Modern Corporation and Private Property, New York: Harcourt, Brace & World

6 Davoudi, L., McKenna, C. & Olegario, R. (2018), 'The Historical Role of the Corporation in Society', *Journal of the British Academy*, 6(s1)

environmental concerns, social tensions and political backlash. These have become particularly acute since the 2007–8 Financial Crisis, as many of the defects of the conventional wisdom were laid bare.

The case for change does not only come from looking backwards at the origins of the corporation and its original foundation in public purpose, but more significantly from looking forward to the forces that are shaping the corporation of the future.

Accelerating and disruptive technological change

Disruptive innovation has always been part of the corporate landscape.[7] The Industrial Revolution marked the demise of many institutions, corporate structures, labour practices, social and political norms and laws, but the birth of others. That continuing process of renewal raises complex and inter-linked economic, social and political questions.[8]

Technological innovation has, in large part, driven globalisation, prompting growing tensions between digitally skilled, location-agnostic commercial corporations and the constraints of nation-based political and legal systems.[9] More specifically, the digital age is bypassing traditional authorities and changing the world of work.[10] Smart technologies are global, networked, intuitive, learning and automated. They rely heavily on trust and trustworthiness of all participants and transform how people and corporations relate to each other. Amongst the most disruptive innovations are artificial intelligence (AI), blockchain, quantum computing and 3D printing, but there are others not yet formed or publicised.[11] Such technologies, many based on data mining and manipulation, are already impacting economic activity, from new ‘clean’ energy to personal communications, medicine and bio-engineering.[12]

Recent analysis suggests that technological innovation may increase incremental profits for first movers, but also reduce innovation incentives for laggards.[13] What is already clear is that the world’s highest value corporations are based around digital ecosystems.[14] Cloud-based, platform businesses rely on global networks of connectivity of both producers and consumers, rather than the single-location, hierarchical, linear structures of the past. The CEOs and board members of the future may have to be as adept at the selection of high-quality algorithms as they are at the management of staff.

The rate of technological change appears to be increasing over time and becoming less predictable.[15] The pace of change exceeds the ability of policy makers and regulators to respond to it. Instead business itself needs to be better placed to manage it with a greater clarity of purpose and an enabling culture to accommodate it.

7 ‘Disruptive innovation’ was coined by Bower, J. L. & Christensen, C. M. (1995), Disruptive Technologies: Catching the Wave, Harvard Business Review, January–February 1995

8 This section primarily summarises findings from Armour, J., Enriques, L., Ezrachi, A. & Vella, J. (2018), ‘Regulation and Law: The Role of Corporate, Competition and Tax Law’, *Journal of the British Academy*, 6(s1), Birkinshaw, J. (2018), ‘How is Technological Change Affecting the Nature of the Corporation?’, *Journal of the British Academy*, 6(s1) and Belenzon, S., Hamdani, A., Kandel, E., Hashai, N. & Yafeh, Y. (2018), ‘Technological Progress and the Future of the Corporation’, *Journal of the British Academy*, 6(s1). Any assertions or findings presented which are more specific are referenced separately.

9 Belenzon, S., Hamdani, A., Kandel, E., Hashai, N. & Yafeh, Y. (2018), ‘Technological Progress and the Future of the Corporation’, *Journal of the British Academy*, 6(s1)

10 The British Academy and The Royal Society (2018) The impact of artificial intelligence on work

11 Belenzon, S., Hamdani, A., Kandel, E., Hashai, N. & Yafeh, Y. (2018), ‘Technological Progress and the Future of the Corporation’, *Journal of the British Academy*, 6(s1)

12 Ibid.

13 Armour, J., Enriques, L., Ezrachi, A. & Vella, J. (2018), ‘Regulation and Law: The Role of Corporate, Competition and Tax Law’, *Journal of the British Academy*, 6(s1)

14 Birkinshaw, J. (2018), ‘How is Technological Change Affecting the Nature of the Corporation?’, *Journal of the British Academy*, 6(s1)

15 Belenzon, S., Hamdani, A., Kandel, E., Hashai, N. & Yafeh, Y. (2018), ‘Technological Progress and the Future of the Corporation’, *Journal of the British Academy*, 6(s1)

2: A framework for business in the 21st Century

The synthesis of the ten themes covered by our research has brought out three principles which could help in the development of a new framework for the future of the corporation: corporate purpose, trust and culture.

A corporation must have a set of clearly defined and aligned purposes — the goals it actively pursues and its contributions to societal goals or public interests. These should be complemented by an inherent commitment to trustworthiness and supported by an enabling organisational culture. The key features of this framework are that it integrates these three principles and requires corporations to take account of a range of stakeholders.

Defining and aligning a corporation's purposes

Corporate purpose is the reason a corporation is created and exists, what it seeks to do and what it aspires to become.[16] It reflects the contribution it wishes to make in furthering the interests of its customers, communities and societies and is the basis on which relations of trust are created in business.[17]

Corporate purpose is distinct from the consequential implications for the corporation's profitability and shareholder returns.[18] The purpose of corporations is not to produce profits. The purpose of corporations is to produce profitable solutions for the problems of people and planet. In the process it produces profits, but profits are not per se the purpose of corporations.

That distinction is fundamental and its confusion in the Friedman Doctrine has been the source of many of the defects of current business practice and policy.[19] All corporate purposes should be intrinsic in the sense that they are core to the businesses and not just driven by shareholder interests.

On the other side of the coin, corporate purpose is sometimes automatically equated with public purpose — the revealed preferences of societies and the public.[20] There are some circumstances in which the purposes of corporations should indeed be equated with those of the public interest. For example, a close alignment and observance of public interests in corporate purpose is particularly relevant to some companies that perform important social functions, such as utilities. However, other corporations should be able

16 This section primarily summarises findings from Hsieh, N., Meyer, M., Rodin, D. & van't Klooster, J. (2018), 'The Social Purpose of Corporations: A Literature Review and Research Agenda', *Pending Publication*. Any assertions or findings presented which are more specific are referenced separately.

17 Kirby, N., Kirton, A. & Crean, A. (2018), 'Do Corporations have a Duty to be Trustworthy?' *Journal of the British Academy*, 6(s1)

18 Hsieh, N., Meyer, M., Rodin, D. & van't Klooster, J. (2018), 'The Social Purpose of Corporations: A Literature Review and Research Agenda', *Pending Publication*

19 Buckley, P. J. (2018), 'Can Corporations Contribute Directly to Society or only through Regulated Behaviour?', *Journal of the British Academy*, 6(s1)

20 Hsieh, N., Meyer, M., Rodin, D. & van't Klooster, J. (2018), 'The Social Purpose of Corporations: A Literature Review and Research Agenda', *Pending Publication*

to pursue purposes that are not necessarily prescribed by public preferences.

The importance of corporate purpose derives from the fact that it is the basis on which relations of trust are created in business.[21] When corporations commit to a purpose, they commit to the various parties that are involved in the delivery of it and, in return, the parties to the firm commit to the attainment of the corporate purpose. This creates reciprocal benefits for the firm, its stakeholders and society at large.[22] It promotes more loyal customers, more engaged employees, more reliable suppliers, more supportive communities and more participative investors. In other words it raises revenue and lowers costs, thereby benefiting firms as well as their associated parties.

There are two reasons why societies become entitled to make claims on corporations and their purpose, both based on the principle of reciprocity:[23]

1. Corporations rely on society's legal, social and political systems for adjudication and protection. They depend on access to infrastructure, health, education and other public resources, and they are a constant source of social and economic disruption.

2. While efficiency and market competition are often cited as forces that might steer firms to promote public purposes, pervasive market failures suggest public purpose cannot be left entirely to the competitive forces guiding profit-seeking corporations. A web of market imperfections obstructs that goal.

Defining a corporation's public purposes quickly raises difficult political questions. Public purposes cannot be determined by the corporation alone due to limitations in the ability of corporate governance systems to balance and judge competing stakeholder interests, and the fact that corporations interact within political and social structures. Developing robust systems and approaches for balancing these competing interests will require a significant effort on the part of business leaders and policy makers.

Another challenge is the meaningful measurement of corporate and social purpose. Most current measures of corporate purpose are accounting measures of material and financial capital and profit. Public purposes also require holistic action-guiding measures for environmental, social and governance impacts. However, none are yet satisfactory, and measurement remains the most important condition for creating a working approach to managing and delivering aligned purposes.

Public purposes are particularly relevant to corporations that perform public functions. These include utilities, corporations with significant market power, private infrastructure providers, corporate partners in private finance initiatives and public private partnerships, and banks. There is a particularly strong case for aligning the purposes of these corporations with their public purposes. Elsewhere such alignments should be restricted to those aspects of corporate activities that raise particular public interests, in relation to, for example, corporate taxation, human rights and corruption.

Embedding a commitment to trustworthiness

Most existing business theories focus on the importance of respecting contractual obligations, but trust and trustworthiness are as important as legal obligations.[24] All disciplines that

21 Kirby, N., Kirton, A. & Crean, A. (2018), 'Do Corporations have a Duty to be Trustworthy?' *Journal of the British Academy*, 6(s1)

22 Ibid.

23 Hsieh, N., Lange, B., Rodin, D. & Wolf-Bauwens M. L. A. (2018), 'Getting Clear on Corporate Culture', *Journal of the British Academy*, 6(s1)

24 This section primarily summarises findings from Kirby, N., Kirton, A. & Crean, A. (2018), 'Do Corporations have a Duty to be Trustworthy?' *Journal of the British Academy*, 6(s1). Any assertions or findings presented which are more specific are referenced separately.

interact with business – including law, finance, economics, sociology and psychology — recognise the importance of trust.[25] Trust embodies a set of values, including competency, reciprocity, consistency and dignity that reduce risk, bind parties together and build value.[26] In a global, digitally-connected society where reputation is built via random networks over which corporations have little or no control, the successful corporation of the future will be built on trustworthiness, defined as *"a robust disposition to fulfil given commitments"*.[27]

Right
In a global, digitally-connected society, the successful corporation of the future will be built on trustworthiness.

Our research tests, examines and distinguishes between a number of circumstances and implications of possible public policies to increase the trustworthiness of corporations.[28] One conclusion is that the overall social benefits of policies that aim to ensure corporate trustworthiness will not always outweigh their social costs. If everyone had a moral right to deal with a trustworthy corporation, then that right would apply regardless of any utilitarian cost-benefit analysis. An alternative is to encourage stakeholders to 'cost in' any possible harms arising from breach of trust and adjust their terms of trade accordingly.

Furthermore, our research argues that only under certain circumstances should there be an absolute right to trustworthiness from a corporation.[29] There is a particular duty on corporations to demonstrate trustworthiness where there is a dependency of others on it, incapacity to avoid the consequences of its violation, or subordination of the interests of one party to those of another. Elsewhere, well-founded trust and trustworthiness are valuable. They promote the social efficiency of capitalism, decrease its risks, allow for respect, validate reciprocity and safeguard dignity.[30]

Building trustworthiness through the distribution of corporate duties is desirable and costly, and this responsibility can and should be encouraged by a range of internal and external measures. Particularly important in this regard is the culture of a corporation.

An enabling culture

There is consensus on the importance of corporate culture and its integrative and holistic

25 Kirby, N., Kirton, A. & Crean, A. (2018), 'Do Corporations have a Duty to be Trustworthy?' *Journal of the British Academy*, 6(s1)
26 Ibid.
27 Ibid.
28 Ibid.
29 Ibid.
30 Ibid.

essence, but little on how it is defined, let alone measured and influenced.[31] The concept of corporate culture derives from anthropological and sociological studies of the 1970s and 1980s. Most definitions centre on similar ideas of organisational culture as a social phenomenon, concerning mental and physical values, and relating to the facilitating or hindering of certain kinds of action. Culture is a multi-layered framework that can be developed to different degrees in different sectors and industries as well as in different units within a firm.

Culture is vital as a facilitator of strategy and is particularly important when implementing corporate changes, notably technological change.[32] Several studies have demonstrated a clear correlation between negative business performance and cultural obstacles.[33] A weak or damaging culture is recognised as a cause of excessive risk aversion, thinking in silos instead of multilaterally, and linear rather than networked transfer of information. But, despite this, corporate culture is still seen as a 'soft' resource, elusive to define and difficult to measure and manage. The proliferation of measurement frameworks for organisational culture, using a mix of qualitative and quantitative techniques is not assisting efforts to clarify and apply the concept.[34]

A key aspect of culture is its role in promoting ethical standards of integrity and honesty in corporations as reflected in their values and codes of conduct and in particular, *"other-"* as against *"self-regarding"* or selfish interests of their employees.[35] Those values must be respected and adopted throughout the corporation to avoid wide disparities between a corporation's declared culture and the actual norms and expectations operating within the organisation. False culture can block change, defeat governance and provoke financial instability. One source suggests culture accounts for 20-30% of the differential in relative corporate performance.[36]

To be more than empty words, culture needs to be embedded in organisational practices.[37] There are a number of ways of doing this, most of which rely on the organisation's leaders to demonstrate the core values and strategic priorities of the culture, ensuring flat hierarchies and avoiding micro-management. The style and delivery of leadership and the life-cycle of the corporation itself will influence corporate culture and it is constantly changing as, for example, some workers choose flexible and independent work in preference to linear job-for-life employment that corporations once championed. While culture usually evolves organically, there are circumstances where a corporation might actively change its own culture: in response to external or internal targets and pressures or radical changes in management.[38]

Together, the three principles of defined corporate purposes, trustworthiness of corporations and enabling corporate cultures offer the potential to reconceptualise corporations as humane and productive and address the challenges, needs and opportunities of society in the 21st century. But how should we bring them about?

31 This section primarily summarises findings from Hsieh, N., Lange, B., Rodin, D. & Wolf-Bauwens M. L. A. (2018), 'Getting Clear on Corporate Culture', *Journal of the British Academy*, 6(s1). Any assertions or findings presented which are more specific are referenced separately.
32 Ibid.
33 For example, Goran, J, Srinivasan, R. & LaBerge, L. (2017) Culture for a digital age. McKinsey & Company: McKinsey Quarterly, July.
34 For a detailed review of frameworks, see Hsieh, N., Lange, B., Rodin, D. & Wolf-Bauwens M. L. A. (2018), 'Getting Clear on Corporate Culture', *Journal of the British Academy*, 6(s1)
35 Crean, A., Gold, N., Vines, D. & Williamson, A. (2018), 'Restoring Trust in Financial Services: Governance, Norms and Behaviour', *Pending publication*, 6(s1)
36 Hsieh, N., Lange, B., Rodin, D. & Wolf-Bauwens M. L. A. (2018), 'Getting Clear on Corporate Culture', *Journal of the British Academy*, 6(s1)
37 Coleman, J. (2013) Six Components of a Great Corporate Culture. Boston: Harvard Business Review. 2- 4.
38 Hsieh, N., Lange, B., Rodin, D. & Wolf-Bauwens M. L. A. (2018), 'Getting Clear on Corporate Culture', *Journal of the British Academy*, 6(s1)

3: The levers of change

There are a range of possible tools and levers available to business leaders and governments to promote change.

Here we consider five: ownership, corporate governance, regulation, taxation, and investment. But this list is not exhaustive; for example, incentives and measurement are frequently mentioned as critical determinants of behaviour.[39] However, the five levers lay the foundations for a more precise and detailed consideration of policy for the next phase of our research.

Ensuring owners play their part

Our research suggests that ownership is at the heart of the failure of the conventional framework to depict the public corporation correctly.[40] As mentioned above, it ascribes rights to shareholders equivalent to the property rights of owners. But shareholders are not necessarily owners and in many cases make no pretence to be so. In particular, the conventional view does not ascribe corporate purpose to shareholders beyond their own financial interests. In other words, it does not attribute a responsibility beyond the achievement of shareholder value.

In contrast ownership in the context of purposeful corporations is intimately associated with defining and delivering corporate purpose. It does not automatically attribute property rights to shareholders but recognises that different owners might be best suited to the achievement of different firms' purposes. It points to the desirability of diversity of ownership. In some companies it might be associated with financial institutions, in others with families and foundations and in others with employees. In all cases someone should be responsible for the corporate purpose. The *"best owner"* is not necessarily the creator of the greatest shareholder value but the most enlightened and visionary deliverer of corporate purposes.[41]

Ownership in many countries has changed significantly since the 1950s.[42] There has been a shift from individual and retail ownership to institutional ownership; growing concentration of ownership in professional asset managers; declines in publicly listed companies; globalisation of finance; and a change from active to passive investment strategies by institutional investors. Each of these has had profound influences on the nature of corporate purposes. However, research will be needed to establish the precise form of that relation and public policy should recognise the importance of it.

Improving corporate governance frameworks

To date, corporate governance — the allocation of decision-making power and influence within the corporation — has been associated with aligning the interests of management

39 Hsieh, N., Meyer, M., Rodin, D. & van't Klooster, J. (2018), 'The Social Purpose of Corporations: A Literature Review and Research Agenda', *Pending Publication* and Gordon, J. (2018), 'Is Corporate Governance a First Order Cause of the Current Malaise?', *Journal of the British Academy*, 6(s1) and Buckley, P. J. (2018), 'Can Corporations contribute directly to society or only through regulated behaviour?', Journal of the British Academy, 6(s1)

40 This section primarily summarises findings from Villalonga, B. (2018), 'The Impact of Ownership on Building Sustainable and Responsible Business', *Journal of the British Academy*, 6(s1). Any assertions or findings presented which are more specific are referenced separately.

41 Villalonga, B. (2018), 'The Impact of Ownership on Building Sustainable and Responsible Business', *Journal of the British Academy*, 6(s1)

42 Gordon, J. (2018), 'Is Corporate Governance a First Order Cause of the Current Malaise?', *Journal of the British Academy*, 6(s1)

with shareholders and promoting shareholder value. Our research suggests that it should instead be recognised as a key tool in delivering corporate purposes.

Achieving this will require significant changes to existing corporate governance arrangements. The new Corporate Governance Code in the UK has gone further in this direction than any previous attempt to date.[43] Principle B of the Code states 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."* Companies that do not comply with the provisions of the Code will be required to explain why they do not do so.

Other recent proposals go further than this in prescribing the types of governance arrangements companies should adopt. In the United States, Senator Elizabeth Warren has proposed an Accountable Capitalism Act setting out a co-determination approach to corporate governance.[44] It takes the view that the relentless maximisation of shareholder value is the root cause of many economic and governance problems. However, it also recognises the risk of co-determination degrading the economic performance of some companies, so only the largest are targeted by the proposed legislation. Similarly in the UK, the Labour Party is proposing a combination of employee ownership and employee board representation in larger companies.[45]

"

The board should establish the company's purpose, values and strategy

Whether change needs to be mandated, as suggested by Elizabeth Warren and the UK Labour Party proposals, or encouraged, as under the Corporate Governance Code, depends on the extent to which it is accompanied by supportive purposeful ownership as described in the previous section. Without owners who effectively promote purposeful governance and protect management from corporate raiders that equate purpose with profits, then governance codes on their own are unlikely to be adequate.

Failures of corporate governance in part result from the flawed composition of corporate boards.[46] Independent directors may be insufficiently informed and committed to serve as credible monitors of management's strategy and operational performance, and the concept of board-monitoring may not be suited to corporations whose projects and business strategy are difficult for equity markets to evaluate. Addressing this requires the identification of new measures of corporate performance that extend beyond financial returns and relate to human, social and natural capital as well as financial capital.

Even if ownership and governance are aligned then companies cannot on their own insure their stakeholders against the systemic risks of technological changes and globalisation to which they are being increasingly subject.[47] This may require governments to bear some of the risks of, for example, the consequential reskilling needs of employees. We return to partnerships between public and private sectors below when we consider reframing investment around corporate purposes.

43 Financial Reporting Council (2018), The UK Corporate Governance Code, July.
44 See https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act.pdf
45 See speech by John McDonnall (24 September 2018), Shadow Chancellor, proposing an *"Inclusive Ownership Fund"*
46 Gordon, J. (2018), 'Is Corporate Governance a First Order Cause of the Current Malaise?', *Journal of the British Academy*, 6(s1)
47 Ibid.

Making regulation work

Globalisation, digitalisation and rapid technological innovation have enabled unprecedented mobility for key corporate functions and assets, including intellectual property rights, administration centres, production and sales.[48] However, the analysis conducted for our research shows that the speed and reach of that capability is posing major questions for current models of regulation and taxation.[49]

How can regulators and lawmakers resist intellectual and regulatory capture through open lobbying and more subtle forms of influence? How can states maintain corporate tax revenues in the face of fiscal arbitrage and tax competition? How can regulators clamp down on profit-shifting and strategic transfer pricing?

These questions fuel doubts about the trustworthiness, transparency and accountability of both corporations and governments. The lag between technological changes that result in disruptive business models, and the corresponding regulations and institutional changes that are needed to maintain public confidence has increased.[50] One way to address this is through 'forward compliance'[51] - a dynamic response where corporations are expected to deliver conduct 'consistent with anticipated regulatory requirements', shifting supervisory onus from regulators to firms themselves.

"

In the UK and US, corporate tax rates declined from around 40% in 1980 to 25% by 2015.

As outlined in our research, many companies incorporate and promote social responsibility in their corporate purposes and at the very least appreciate the need to 'do no harm'. There is a large array of codes of conduct, standards and guidelines available to support such objectives. However, alignment of corporate with public purposes needs to be made explicit in the case of corporations that perform social and public functions, such as utilities and corporations with significant market power. In these cases, regulation should require companies to incorporate their licences to operate in their charters and articles of association, thereby imposing fiduciary responsibilities on directors to uphold their public as well as private purposes.

Reforming corporate taxation

Globalisation has proven highly rewarding for an increasingly concentrated pool of

48 Birkinshaw, J. (2018), 'How is Technological Change Affecting the Nature of the Corporation?', *Journal of the British Academy*, 6(s1)

49 This section primarily summarises findings from Armour, J., Enriques, L., Ezrachi, A. & Vella, J. (2018), 'Regulation and Law: The Role of Corporate, Competition and Tax Law', *Journal of the British Academy*, 6(s1). Any assertions or findings presented which are more specific are referenced separately.

50 Birkinshaw, J. (2018), 'How is Technological Change Affecting the Nature of the Corporation?', *Journal of the British Academy*, 6(s1)

51 Armour, J., Enriques, L., Ezrachi, A. & Vella, J. (2018), 'Regulation and Law: The Role of Corporate, Competition and Tax Law', *Journal of the British Academy*, 6(s1)

corporate owners, but it has also alienated and displaced other interests.[52] It has raised incomes in low-income countries but concentrated wealth in high-income countries. In the UK and US, corporate tax rates declined from around 40% in 1980 to 25% by 2015.[53] Erosion of corporate tax has created opportunities for those with higher personal income tax rates to use corporations as vehicles for deferral of taxes.[54]

Corporate taxation is in need of urgent reform and several alternatives have been considered. One involves shifting both corporate and personal taxes from a focus on production to consumption; another is to move personal taxation to an accrual basis. There are limitations to both. A third approach is to consider how corporations can be encouraged to promote a more socially responsive agenda that includes a willingness to pay a *"fair share"* of taxes as part of their corporate purposes.[55]

Reframing investment around a corporation's purposes

The relationship between socially responsible business practices and financial performance has been the active subject of research.[56] In early studies, results were mixed: socially responsible practices did not necessarily correlate with financial performance and in some cases detracted from it. More recent studies suggest that corporations that embed environmental, social and governance values perform better than other firms and are less prone to failure.

Private capital markets are often thought to suffer from short-termism in the allocation of financial resources for investment. The short payback periods that financial markets require of corporate investment constrain the projects that the private sector can support, necessitating the participation of the public sector in large-scale, long-term investments, such as infrastructure projects.

The relative merit of private and public sector ownership and investment has been lent particular significance by the success of the Chinese economy, and the poor record of investment by some privatised corporations in the west.[57] In some cases, this is raising the prospect of renationalisation of previously privatised entities and contracted out activities.

It is in precisely where private corporations deliver public services that corporate purposes should be aligned with public purposes. As described above, this can be achieved through incorporating licence to operate conditions in companies' charters and articles of association, thereby imposing a fiduciary duty on directors of corporations to uphold their public as well as private purposes.

Together reform of ownership, governance, regulation, taxation and investment offer the prospect of establishing the purposes, trustworthiness and cultures that are needed of 21st century corporations.

52 A number of papers within the programme comment on this general trend: Armour, J., Enriques, L., Ezrachi, A. & Vella, J. (2018), 'Regulation and Law: The Role of Corporate, Competition and Tax Law', *Journal of the British Academy*, 6(s1), Gordon, J. (2018), 'Is Corporate Governance a First Order Cause of the Current Malaise?', *Journal of the British Academy*, 6(s1)

53 Desai, M. & Dharmapala, D. (2018), 'Revisiting the Uneasy Case for Corporate Taxation in an Uneasy World', *Journal of the British Academy*, 6(s1), based on World Revenue Longitudinal Dataset (WoRLD), available at: http://data.imf.org/revenues

54 This section primarily summarises findings from Desai, M. & Dharmapala, D. (2018), 'Revisiting the Uneasy Case for Corporate Taxation in an Uneasy World', *Journal of the British Academy*, 6(s1). Any assertions or findings presented which are more specific are referenced separately.

55 Buckley, P. J. (2018), 'Can Corporations Contribute Directly to Society or only through Regulated Behaviour?', *Journal of the British Academy*, 6(s1)

56 Villalonga, B. (2018), 'The Impact of Ownership on Building Sustainable and Responsible Business', *Journal of the British Academy*, 6(s1)

57 Offer, A. (2018) 'Patient and Impatient Capital: Time Horizons as Market Boundaries', *Pending Publication*

Conclusions

The findings of this research call into question the notion in the Friedman Doctrine that the one and only social responsibility of business is to increase profits while abiding by laws and social norms. It has noted that the corporation was created to perform a public function.[58] It is only over the last 50 years that the preoccupation with profits has emerged.

This was a response to the problem of the lack of accountability of management resulting from the separation of ownership and control that emerged as a consequence of the growing dispersion of shareholdings during the first half of the twentieth century. Shareholder primacy was promoted on the basis of a property right view of the corporation that associated shareholder rights with its ownership.

This was a mistake and it is the source of the growing disaffection with business, its environmental, social and political problems, and the erosion of trust in it. Those problems will be intensified in the future by technological advances that risk exacerbating social detriments as well benefits of corporations and lengthening the regulatory lag between innovations and policy response.

Reimagining the role of business for the 21st century requires a new framework that combines and connects defined corporate purposes, a commitment to trustworthiness and an enabling corporate culture.

The purpose of the corporation is the reason it exists, what it seeks to do and what it aspires to become. The purpose of the corporation is to produce profitable solutions for the problems of people and planet. In the process it produces profits. But the purpose of business is not to produce profits *per se*, nor to profit from producing problems for people and planet.

In some cases where corporations perform important social functions, for example in utilities, companies with significant market power and those engaged in the provision of public services and public-private partnerships, corporate purposes should be aligned with public purposes that reflect the interests and preferences of society and the public at large. But this does not apply to other corporations as a requirement.

Corporations commit to the creation and fulfilment of their corporate purposes. In the process they commit to the various parties to the firm that are involved in the delivery of those purposes. Those parties in turn commit to the corporation. This creates relations of trust that produce mutual benefits to the corporation and the parties associated with it. They are reflected in higher revenues, lower costs and greater profits of corporations.

The ability of the corporation to commit to its purposes, and the parties associated with it, derives from its trustworthiness. This trustworthiness in turn is a reflection of the internal norms and values of the corporation based on a culture of honesty, integrity and other- rather than self-regarding interests. It should be promoted by the leadership and embedded consistently throughout the corporation.

There are five levers used to promote corporate purposes, trustworthiness and enabling

58 It is important to note that the relevance of this finding is in the fact that corporations were established with a defined public purpose, rather than passing judgement on the nature of that purpose.

corporate cultures. The first is **ownership**. The ownership of corporations is currently associated with shareholdings. That is a mistake and leads to an inappropriately restrictive conception of ownership. Instead, ownership should primarily be related to the formulation and implementation of corporate purpose. There are many forms of ownership that are associated with this including individual, family, institutional, employee, cooperative, mutual and public ownership, depending on the nature of corporate purposes. This points to the importance of diversity of ownership and the responsibilities as well as rights that go with it.

The second lever is **corporate governance**. At present this is primarily linked to the alignment of managerial interests with those of shareholders. Again, this is a mistake. Corporate governance is the means by which corporate purposes are implemented by management in the organisation, and the appropriate values and culture are adopted. The particular form that corporate governance takes will therefore be specific to the nature of the firm's corporate purposes and the particular requirements to deliver them.

The third lever is **regulation**. Technological advances are lengthening the lag between regulation and the innovatory processes and products that corporations are swiftly adopting. This is intensifying the failure of policy to correct the detriments created by corporations motivated predominantly by a profit purpose. Instead regulation should be seeking to align corporate with public purposes in those organisations and circumstances where it is most relevant because of the social function performed by corporations. This can be achieved through, for example, incorporating public purposes in the charters and articles of association of private corporations.

The fourth lever is **taxation**. Globalisation is intensifying the inability of nation states to use corporate taxation as a source of public revenue. Attempts to rectify this through alterations to the structure of corporate taxation have not been successful to date. This reflects a failure of corporations to recognise and respond to their dependence on societies and nation states through including payment of fair shares of taxes in their corporate purposes.

The final lever is **investment**. The provision of large-scale, long-term investments involves the participation of government as well as the private sector. The performance of privatisations and partnerships between the public and private sector in their delivery has often been disappointing. It is in precisely these areas where corporations are performing significant public and social functions that corporate purposes should be aligned with public purposes by incorporating the latter in the charters and articles of the association of the former.

Together these five levers of ownership, governance, regulation, taxation and investment can create 21st century corporations with corporate and public purposes delivered in a trustworthy manner with cultures of integrity.

In the next phase starting in 2019, the Future of the Corporation programme will begin to develop precise business practice and policy implications of the framework identified in this first phase. In particular, it will consider the laws and regulation, ownership and governance, and measurement and management required by the new framework. The British Academy will continue to support rigorous and objective research and analysis to underpin the programme, publishing new findings as they emerge, and will commit to convening leaders and engaging widely in order to reimagine the future collectively and purposefully.

Contributing papers

The research for the Future of the Corporation Programme was commissioned by the British Academy in early 2018. 31 distinguished academics contributed papers that were peer reviewed. None of the papers have been previously published. The academic lead on the Future of the Corporation Programme is Professor Colin Mayer of the University of Oxford Saïd Business School.

Paper 1	Davoudi, L., McKenna, C. & Olegario, R. (2018), 'The Historical Role of the Corporation in Society', *Journal of the British Academy*, 6(s1)
Paper 2	Hsieh, N., Meyer, M., Rodin, D. & van't Klooster, J. (2018), 'The Social Purpose of Corporations: A Literature Review and Research Agenda', *Pending Publication*
Paper 3	Kirby, N., Kirton, A. & Crean, A. (2018), 'Do Corporations have a Duty to be Trustworthy?' *Journal of the British Academy*, 6(s1)
Paper 4	Crean, A., Gold, N., Vines, D. & Williamson, A. (2018), 'Restoring Trust in Financial Services: Governance, Norms and Behaviour', *Pending Publication*
Paper 5	Hsieh, N., Lange, B., Rodin, D. & Wolf-Bauwens M. L. A. (2018), 'Getting Clear on Corporate Culture', *Journal of the British Academy*, 6(s1)
Paper 6	Gordon, J. (2018), 'Is Corporate Governance a First Order Cause of the Current Malaise?', *Journal of the British Academy*, 6(s1)
Paper 7	Belenzon, S., Hamdani, A., Kandel, E., Hashai, N. & Yafeh, Y. (2018), 'Technological Progress and the Future of the Corporation', *Journal of the British Academy*, 6(s1)
Paper 8	Birkinshaw, J. (2018), 'How is Technological Change Affecting the Nature of the Corporation?', *Journal of the British Academy*, 6(s1)
Paper 9	Desai, M. & Dharmapala, D. (2018), 'Revisiting the Uneasy Case for Corporate Taxation in an Uneasy World', *Journal of the British Academy*, 6(s1)
Paper 10	Armour, J., Enriques, L., Ezrachi, A. & Vella, J. (2018), 'Regulation and Law: The Role of Corporate, Competition and Tax Law', *Journal of the British Academy*, 6(s1)
Paper 11	Offer, A. (2018) 'Patient and Impatient Capital: Time Horizons as Market Boundaries', *Pending Publication*
Paper 12	Villalonga, B. (2018), 'The Impact of Ownership on Building Sustainable and Responsible Business', *Journal of the British Academy*, 6(s1)
Paper 13	Buckley, P. J. (2018), 'Can Corporations Contribute Directly to Society or only through Regulated Behaviour?', *Journal of the British Academy*, 6(s1)

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The conclusions of this report have been guided by the advice and insights of the Steering Group and Corporate Advisory Group. Members acted in an individual, not representative capacity and the views expressed in this report are not necessarily those of each member.

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We are keen to collaborate with other research and policy initiatives that are covering similar issues. We maintain a regular series of events and we will continue to share invitations to these events and updates on the project by way of our mailing list. To get involved in the programme, please register your details on our mailing list with this link:

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