a blueprint for better business

Below is the transcript of the speech made by John Kay at our conference on 30 October 2014

The Future of Purpose-Driven Business - John Kay

Let me start then with the lawyers, because if we do not start with the lawyers, as I think Mike Rake indicated then we are very likely to end up with the lawyers! It is as well to get them out of the way to begin with. I think when one makes that point I would also like to make the point that we have had a good deal of discussion this morning about transparency and I think it is quite important that we recognise that transparency is not so much the vehicle to trust as the demand for transparency is an indication for the absence of trust. When you quiz your children about where they have been for the evening it is not because you are confident that they have behaved well, it is because you are *not* confident that they have behaved well and if you are confident that they have behaved well then you probably don't bother to ask them for the information. The truth is I believe we have gone too far down the transparency route in many ways and as a result we have created annual reports that run to several hundred pages, most of which are of no interest to anyone and they are not, in fact, read by anybody. Trust and transparency are not the same thing and we should not regard transparency as a substitute for trust. But that is an incidental aspect of what we can learn from the lawyers. I would, I was going to say I would be rich but I would not be rich, I would have enough at least for a decent meal if I had a pound for every person in business who has told me that the purpose of business is to create money for shareholders or importantly has said that the *law* says that the purpose of business is to make money for shareholders. I think it is quite important to emphasise that the law doesn't say that the purpose of business is to make money for shareholders, in fact, which is helpful because it helps get the lawyers off the scene, the law doesn't say anything at all about the purpose of business. However the law does say some relevant things about the duties of directors and the duty of a director in particular, under British company law is to promote the success of the company for the benefit of the members. What is quite important here is to notice that it doesn't say that the job of the director is to benefit the members. That quite important phrase; 'the success of the company' has been inserted in that particular formulation and let us be clear that it was not inserted by accident in company law. It was inserted there with a deliberate design. The duty of the director of a company in Britain is to promote the success of the company and it should be clear to anyone who thinks about that even for a moment realises that the success of a company is something that is essentially multi-dimensional. People have told me that this may rather curiously be true in Britain but it is not true in other countries well it is certainly not true in the United States, that the purpose of a company is to make money for its shareholders. Indeed the totality of these matters is a good deal vaguer in the United States than it is in Britain and some of you may have been familiar with the recent bulk buy Lynn Stout, professor of law at Yale. It is somewhat surprising if you read it as a British readers conclusion that British law is far more shareholder friendly than United States law and as a matter of fact, it is, it gives many more rights to shareholders than are available under US law and particularly under statues and case law Delaware which is the states in which a majority of large US corporations are located. US law is not, in that sense, different from UK law and this is an issue that varies across different countries but there is actually no support for the legal proposition that that is the obligation of directors of a company or that that is legally defined as the purpose of business. The second thing that the lawyers can help us with is that what is central to British company law and indeed American company law also is the doctrine of corporate personality, it says that the company is an entity independent of its members, independent of its managers or anything else. That is something that was created in the 19th century that doctrine of corporate personality and it is at the centre of the way in which the law thinks about corporations.

Having talked about the lawyers for a few minutes, let's move down the corridor and talk to the economists. One of the surprising things for people who don't know anything about economics and it is a bit surprising even for people who do is that economics doesn't spend very much time talking about firms. Standard economic models that people use don't actually have firms in them, they don't as many more people now know usually have money in them either and a few people have thought that these are quite big deficiencies in the economic models and I am inclined to share their view but economists haven't devoted much attention to the issue of what is a firm but there are two broad theories of what a firm is. One has won the Nobel Prize for its architect, a British economist as a matter of fact called Ronald Koanes. I wrote an obituary of him when he was 95, the Financial Times having noted he was 95 and thinking that it was pretty urgent to have an obituary, actually that sat on their files for another seven years before they had occasion to pull it out but he did die last year at the ripe old age of 102. Koanes' theory which is essentially that the boundaries of a firm were defined by the difference between markets and hierarchies. There are some things that are best done by command and control and some transactions that are best mediated through markets. What determined the right size of a firm was deciding which transaction should be done on the command and control basis and which should be done on the market basis. That kind of theory is clearly relevant and important to a lot of decisions like what can a company outsource or what should it outsource and what can't it do on that.

Second group of theories of the firm came from another British economist called Edith Penrose in the 1960's, we don't give Nobel prizes in economics to women I'm afraid and she didn't actually get one for this. Edith Penrose defined the firm in terms of a group of capabilities and what distinguishes a firm are the particular capabilities that that firm has differentially from other firms. Having picked up one or two pearls of wisdom, I think you'll agree, from the economists we might move down the corridor to the business strategists. The management people, those of you who know a little bit about business strategy will have been familiar with the work of Michael Porter one of these many books, Thomas Piketty's book on Capital is another one, which appear to be rather more bought than read. Certainly in most cases I have seen the books on many more shelves than the people who I believe have read them. Porter defined the strategic challenges faced by a firm in terms of what he called the 'five forces'; competition, substitution, dealing with supplier's, dealing with consumers and facing new entrants. You think of that list for a moment and you notice one thing about which is that it doesn't do anything to explain why one firm is different from another firm in the same industry because these firms faced the same competitors, the same substitutes, the same supplier's, the same consumers and the same potential entrants. Then a way of thinking about business strategy that does draw on that Penrosian tradition and talks about the strategy of the firm in terms of defining the capabilities of the firm and understanding that the strategic advantage you might develop as a firm depends on identifying what is distinctive in terms of these capabilities. While we are talking to the business strategists, we might take a moment, they wouldn't be allowed inside the royal academy I'm afraid Sorry Jon [to Jon Snow], to talk to business journalists. If we look at the business journalists we find once again two views of the firm, one they take in terms of what economists call a principle agent model that is the company is the creature of the shareholders and the managers and the people who work in the firm are there to create shareholder value, the largest strand of business journalism today particularly in the United States is about business as centred around the heroic individual; Microsoft is the creation of Bill Gates and everything that happened in Microsoft reflected the will of Bill Gates that means that if Microsoft somewhat drifted today, what Microsoft should be searching for is a corporate saviour of some kind. Similarly whatever happens in General Electric, even though it is a company that employs several hundred thousand people everything that happens there is the doing of Jack Welch or Jeff Immelt or whoever *happens* to be chief executive of a company at the time. Portraits of companies are almost always centred around interviews with the chief executive that tell us the vision he has for the future of his company. I think you don’t have to understand very much about business to realise this is travesty of how real businesses actually operate.

So let’s move on from the business journalists and talk to the anthropologists because what the anthropologist understand in ways that none of the people I have talked to already do is that most of what happens in business as with everywhere else in our lives, happens in small groups of people. It is the relations between people in these small groups that determine the performance of the organisation and it is the interactions between these small groups that are what the structure of the business and the direction of the senior management should be intended to do. That’s a very different take on business from the one generated by the cult of the heroic individual. A few years ago when I was teaching at London business school I brought along a retired chief executive to talk to the class and at the end of the class he said to me “you know these kids regard being chief executive of a business as a prize rather than a responsibility” and I think in that particular phrase he encapsulated more than almost anything I have heard what has gone wrong with how we think about business over the last two or three decades.

Finally as we go along the corridor at the British academy, we might talk to the philosophers I mentioned there were linguistic philosophers, I don’t find it helpful to talk to them about very much but in this particular context we might notice that when we talk about business we can talk about the purpose of business and we talk about the function of business we talk about the role of business, we talk about the objectives of business, we talk about the goals of business and we use these words almost interchangeably. People who think that business is about profit use it in all these contexts, people who want to talk in wider terms use that too. I think a philosopher would remind us that these are actually words that have different meanings, they are different words in the English language because they have different connotations and for example we in our individual lives have proximate goals and these are very different goals from our objectives or our purposes and it is useful in thinking about business to distinguish in all of these in particular. As an economist I learnt when I started to study business that business didn’t really maximise profits. Because it is the way that economists think, I thought for a long time, so they don’t maximise profits, what is it that they do maximise? And one day the scales fell from my eyes and I realised that businesses don’t actually maximise anything. They are complex organisations which respond to the interactions between people that actually give rise to them. Business is in that sense more complicated. The linguistic philosophers can help us with that. The moral philosophers can help us too, in the ways about which we, in this conference, a dialogue you know a year ago when we talked on one hand about catholic social teaching and its relevance to thinking about business in terms of not of maximising but of actually managing a balance between the whole range of characteristics that make a good business. In essentially the way that Aristotle taught two millennia ago about the characteristics that made a good life and in which Alasdair MacIntyre, more recently, has revived in what I certainly have found an illuminating expression of this kind of way of thinking and the one that is reflected in catholic social teaching. This is a world in which individuals don't go about maximising anything success as an individual depends on maintaining a balance between a variety of different factors and characteristics and that is true of business as well. And finally we might talk to the political scientists who would be concerned about the social legitimacy of business and the way in which business fits into an overall political scene and about what the political responsibilities and obligations and the limits to these political responsibilities and obligation actually are. We need here I think to be quite carful about this in the way we think about because I think the political role of business should be limited, severally limited actually, and in particular limited to aspects that will relate specifically to the pursuit of business. I don't think I can applaud Anita Roddick for being concerned, as a business woman about the, rainforest without accepting equally the legitimacy, of let us say the Koch brothers in trying to restructure the US political system in a particular ideological style. I don't think I can say the difference between one and the other is that I can say I rather agree with the views that one is trying to express and disagree with the others. I think that neither of these actually have much to do with the proper purposes of business. The political role of business should actually be severely limited and I think one of the great obstacles both to the social legitimacy of business and to the improved performance of business itself is the way in which business, and the financial sector is the worst offender, but one can point to other industries like pharmaceuticals and media where we have the same where we have an utterly inappropriate political involvement in the framing of public policy towards these particular activities.

So having talked to the lawyers, talked to the economists, talked to business strategists, talked to the anthropologists, the philosophers. How do we put all this together? I think a helpful point to start is with that legal doctrine of corporate personality and say this is not just as some lawyers have been inclined to regard it, legal fiction that says that corporation can make contracts and that the contracts in the modern economy are not just things between individuals it actually goes further than that and corporate personality is actually real. Successful corporations in the modern economy are things that actually have the kind of personal characteristics that we attribute to individuals in our society as well. And that is a substantive observation and not just a legal fiction. That is that the firm is not just what a lot of economists have called, a nexus of contract in which people use it as a way to make agreements with each other and the firm is simply a group of people who find it convenient to come together every day and make much the same contracts with each other as they did yesterday. The successful firm is not and cannot be like that, the successful firm adds value in an economic sense only because it is more than the sum of the parts and it is more than the sum of these parts. This takes us to the resource based way of thinking about the nature of corporation, it is more than the sum of these parts because the corporation has a set of distinctive capabilities and characteristics that in business terms generates its competitive advantage and which come out of the relations between individuals than the particular history that has formed that particular corporation in the particular way it does. We start putting all these things together and seeing that a firm is a construct that has purposes not in the sense of the economist of things which it maximises but actually of having a balance of objective and goals and different proximate goals which it will pursue in the light of that the firm has obligations to customers to suppliers, to employees, to society as a whole to the environment and the job of the manager is not to maximise anything but to steer a course in which the business will inevitably drift towards paying too much attention to some of these objectives at the expense of others. And must then be, not re-focussed in some transformational way, but re-steered in order to ensure that it keeps that balance together looking forwards.

That’s the way we should be thinking about organisations, from a legal point of view, business point of view from an economic point of view, from an anthropological point of view. It is also ultimately the way we need to be thinking about business from a moral and political point of view as well because what we need to do is restore, not just trust in business which has been talked about already but the legitimacy of business. If business is about maximising shareholder value then one asks the question ‘why should I allow organisations whose purpose is that to exist in modern society’. There is no good answer to that question or rather the only good answer to what question is that businesses which have as one of their objectives the making a profit are valuable to society because of the services they deliver to society because of the services they deliver to consumers and employees and to society in general and that is the only way in which business can actually justify its continuing existence.

I have tried to give this morning a nuanced account, drawing from a variety of different academic disciplines about how business should operate and what the role of business in society actually should be. I hope it is a very different account from the kind of crass description of business that says ‘of course what business is about is making a profit’ it is about making a profit but profit is no more the purpose of business than breathing is the purpose of living. Thank you all very much.