Gruter Institute Project on
Values and Free Enterprise

With support from:
John Templeton Foundation
UCLA – Sloan Research Program
Ann & Gordon Getty Foundation

What is a Business For?*

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Could capitalists bring down capitalism, wondered the New York Times in the wake of the series of corporate scandals in both America and Europe in recent years? They concluded that a few rotten apples would not contaminate the whole orchard, that the markets would eventually sort out the good from the bad and that, in due time, the world would go on much as before.

Not everyone was so complacent. Markets rely on rules and laws, but those rules and laws in their turn depend upon truth and trust. Conceal the truth or erode that trust and the game becomes so unreliable that no one will want to play. The markets will empty then and prices collapse, as ordinary people find other places to put their money, into their houses, maybe, or under their beds. The great virtue of capitalism, that it provides a way for the savings of society to be transformed into the creation of wealth, will have been eroded and we shall all be the poorer. Either that, or we shall have increasingly to rely on government for the creation of our wealth, something that they have always been conspicuously bad at doing.

In the recent scandals truth seemed to be too easily sacrificed to expediency and the need, as the businesses saw it, to reassure the markets that profits were on target. John May, a stock analyst for a US investor service, pointed out that the pro forma earnings announcements by the NASDAQ 100 companies overstated their profits by $100 billion in the first nine months of 2001 as compared with their audited accounts when these finally appeared. Even those audited accounts, it now seems, were able to make things seem better than they really were.

Trust, too, is a fragile thing. Like a pane of glass, once shattered it can never be quite the same again. To many it has recently seemed that corporate executives were no longer running their companies for the benefit of the consumers, or even of their shareholders and employees, but for their personal ambitions and financial gains. A Gallup poll early in 2002 found that only 18% of Americans thought that corporations looked after their shareholders a great deal and 90% felt that those running the corporations could not be trusted to look after the interests of their employees. 43%, in fact, believed that senior executives were only in it for themselves. In Britain, that figure in another poll was 95%.

What has gone wrong? It is tempting to blame the people at the top. Keynes once said that ‘Capitalism is the astounding belief that the most wickedest of men will do the most wickedest of things for the greatest good of everyone.’ Keynes was exaggerating. Personal greed perhaps, a lack of sufficient scrutiny of the company’s affairs, an insensitivity or an indifference to public opinion, these charges could be levelled against some corporate leaders, but few, thankfully, are guilty of deliberate fraud or wickedness. At worst they were only playing the game according to the rules as they understood them. It is these rules, or, more particularly, the new goal posts that have distorted capitalism.

In the current Anglo-American version of stock market capitalism, the criterion of success now is shareholder value, as expressed by the share price. The directors of a company may insist that the purpose of the business is more than the share price but what is measured is too often what counts. There are many ways of influencing the share price, of which increasing productivity and long-term profitability is only one. Cutting or postponing expenditures that are geared to the future rather than the present will push up the profits immediately even if it imperils the longer term. Buying and selling other businesses is another favoured strategy. It is a far quicker way to boost your balance sheet and your numbers than relying on organic growth, and, for those at the top it can be much more interesting. The fact that most mergers and acquisitions do not, in the end, add value has not discouraged others from trying. One result is an inevitable shortening of horizons. Paul Kennedy is not alone in believing that companies are mortgaging their futures in return for a higher stock price in the present, but he may be optimistic in sensing the coming end of the obsession with shareholder value.

The stock option, that new favourite child of stock market capitalism, must share a large part of the blame. Whereas in 1980 only about 2% of executive pay was tied to share options it is now thought to be over 60% in the US. These executives, not unnaturally, want to realise their options as soon as they can, rather than relying on their successors to deliver. The stock option has also acquired a new popularity in Europe as more and more companies go public. To many Europeans, however, hugely undervalued stock options are just another way of allowing executives to steal from their companies and their shareholders. Europeans raise their eyebrows, sometimes in jealousy but more often in outrage, at the levels of executive remuneration under stock market capitalism. Reports that CEOs in America earn over four hundred times the earnings of their lowest workers make a mockery of Plato’s ideal, in what was then, admittedly, a smaller and simpler world, that no person should be worth more than four times another. Why, some wonder, should business executives be rewarded so much better financially than those who serve their societies in all the other professions? The suspicion, right or wrong, that business takes care of itself before it cares for others only fuels the latent distrust.

Europeans look at America with a mix of envy and trepidation. They admire the dynamism, the entrepreneurial energy and the insistence on everyone’s right to decide their own life. They approve of the fact that America has never used its power to remove sovereignty from other nations or to occupy their territories, as the European empire builders did, preferring instead to use economics as the foundation of its international influence. They worry now, however, that the flaws in the American model of capitalism are contagious and will infect their own economies, as they watch their own stock markets follow Wall Street downhill.

This is not just a question of dubious individual ethics or of some rogue firms fudging the odd billion. The concern is that the whole business culture of America may have become distorted. This was the culture that enraptured America for a generation, a culture which argued that the market was king, that the shareholder always had priority, that business was the key engine of progress and that, as such, its needs should prevail in any policy decisions. It was a heady doctrine, one that simplified life with its dogma of the bottom line, and in the Thatcher years it infected Britain. It certainly revived the entrepreneurial spirit in that country, but it also contributed to a decline in civic society and to an erosion in the attention and money paid to the non-business sectors of health, education and transport – a neglect whose effects have now returned to haunt the successor government.

Continental Europe was always less enthralled by the American model. It left out many of the things that Europeans take for granted – free health care for all, housing for the disadvantaged, quality and free education for all and a guarantee of reasonable living standards in old age, sickness or unemployment. These things that Europeans see as the benefits of citizenship are conspicuously lacking in the land of the free, because they are seen as the price that must be paid for liberty and opportunity. Nevertheless, the accusations from across the Atlantic of a lack of dynamism in Europe, of sclerotic economies bogged down in regulations and of lacklustre management were beginning to hurt, and the culture of stock market capitalism was beginning to take hold. Now, after a series of Europe's own examples of skulduggery at the top and a couple of high profile corporate collapses due to over-ambitious acquisition policies, many are not so sure.

With hindsight, in the boom years of the nineties America had often been creating value where none existed, valuing companies at up to 64 times earnings. Her consumers' level of indebtedness may well be unsustainable along with the country's debts to foreigners. Add to this the erosion of confidence in the balance sheets and in the corporate governance of some of the country's largest corporations and the whole system of channelling the savings of citizens into fruitful investment begins to look in question. That is the contagion that Europe fears.

Capitalist fundamentalism may have lost its sheen, but the urgent question now is how best to retain the energy produced by the old model without its flaws. Better and tougher regulation would help, as would a clearer separation of auditing from consulting. Corporate governance will now surely be taken more seriously by all concerned, with responsibilities more clearly defined, penalties spelt out and watchdogs appointed. But these will be plasters on an open sore, they will not affect the disease that lies at the core of the business culture, which centres around the question: 'Who and what is a business for?' It is a question to which the answer once seemed clear, but which now needs rethinking in a time when ownership has been replaced by investment and when the assets of the business are increasingly to be found in its people not in its buildings and machinery. Are there things that the American business model can learn from Europe, just as there have been valuable lessons that the Europeans have absorbed from the dynamism of the Americans?

Both sides of the Atlantic would agree that there is, firstly, a clear and important need to meet the expectations of the theoretical owners, the shareholders. It would, however, be more accurate to call most of them investors, perhaps even punters. They have none of the pride or the responsibilities of ownership and are, if they are truthful, only there for the money. Nevertheless, failure to meet their financial hopes will only result in a falling share price, expose the company to unwanted predators and make it more difficult to raise new finance. But to turn this need into a purpose is to be guilty of a logical confusion, to mistake a necessary condition for a sufficient one. We need to eat to live, food is a necessary condition of life, but if we lived mainly to eat, making food a sufficient or only purpose of life, we would become gross. The purpose of a business, in other words, is not to make a profit, full stop. It is to make a profit in order to enable it to do something more or better. What that 'something' is becomes the real justification for the existence of the business. Owners know this. Investors needn't care. They are anxious only for their share of that profit.

To many this will sound like quibbling with words. Not so. It is a moral issue. To mistake the means for the ends is to be turned in on oneself, what Saint Augustine called one of the greatest of sins. Deep down, the suspicions of capitalism are rooted in a feeling that its instruments, the corporations, are immoral in that sense - they have no purpose other than themselves. This may be to do many of them a great injustice, but if so they are let down by their own rhetoric and behaviour. It is a salutary process to ask of any organization – 'if it did not exist would we invent it?' 'Only if it was doing something more useful, better or different than anyone else' would have to be the answer, with profits as a means to doing just that.

The idea that those who provide the finance are the rightful owners, rather than just the financiers, dates from the early days of business when the financier was genuinely the owner and usually the chief executive as well. There is, however, a second and related hangover from earlier times, namely the idea that a company is a piece of property, subject to the laws of property and ownership. This was true two centuries ago when company law originated and when a company largely consisted of a set of physical assets. Now that the value of a company largely resides in its intellectual property, in its brands and patents and in the skills and experience of its workforce, it can seem unreal to think it right to treat these things as the property of the financiers, to be disposed of if they so wish. This may be the law but it hardly seems like justice. Surely those who carry this intellectual property within them, who contribute their time and talents rather than their money, should have some rights, some say in the future of what they also think of as 'their' company?

It is worse than that. The employees of a company are treated, by the law and the accounts, as the property of the owners and are recorded as costs not assets in the books. This is demeaning, at the very least. Costs are things to be minimized, assets things to be cherished and grown. The language and the measures of business need to be reversed to recognize this. A good business is a community with a purpose. Communities are things you belong to, not things you can own. They have members, members who have certain rights, including the right to vote or express their views on major issues. It is ironic that those countries that boast most stridently of their democratic principles derive their wealth from institutions that are defiantly undemocratic, with all serious power held by outsiders and power inside wielded by a dictatorship or, at best, an oligarchy.

Company Law in both America and Britain is out-of-date. It no longer fits the reality of business in the knowledge economy. Perhaps it never did. In 1944 Lord Eustace Percy, in Britain, said this: 'Here is the most urgent challenge to political invention ever offered to statesman or jurist. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognized by law. The association which the law does recognize – the association of shareholders, creditors and directors – is incapable of production or distribution and is not expected by the law to perform these functions. We have to give law to the real association and to withdraw meaningless privileges from the imaginary one.' Sixty years later, the European management writer Arie de Geus was arguing that companies die because their managers focus on the economic activity of producing goods and services and forget that their organization's true nature is that of a community of humans. Nothing, it seems, has changed.

The countries of mainland Europe, however, have always regarded the firm as a community, whose members have legal rights, including, in Germany for instance, the right for their employees to have half, minus one, of the seats on the supervisory board, as well as numerous safeguards against dismissal without due cause and an array of statutory benefits. These rights certainly limit the flexibility of management but they help to cultivate a sense of community which, in the long-term can prove beneficial, generating a loyalty and commitment that can see the company through bad times as well as the sense of security that makes innovation and experiment possible. The shareholders, in this view of the company, are seen as trustees of the wealth inherited from the past. Their duty is to preserve and, if possible, to increase that wealth so that it can be passed on to successor generations.

It is made easier in mainland Europe because of the more closed systems of ownership and the greater reliance on long term finance from the banks. Hostile takeovers are rare and difficult since private shareholders hold only small proportions of the total equity capital while pensions are mostly kept inside the firm, on the liabilities side of the balance sheet and used as working capital. Pension funds, therefore, are small and most equity holdings are in the hands of other companies, the banks, or family networks. The precise proportions and governance structures differ from country to country but, in general, it can be said that the cult of the equity is not prominent in mainland Europe.

Countries are shaped by their history. There is no way that the Anglo-Saxon countries could adopt any of the different European models, even if they wished to. Both cultures, however, need to restore confidence in the wealth-creating possibilities of capitalism and in its instruments, the corporations. In both cultures some things need to change. More honesty and reality in the reporting of results would help, for a start, but when so many of the assets of a business are now literally invisible, and therefore uncountable; and when the webs of alliances, joint ventures and sub-contracting partnerships are so complex, it will never be possible to present a simple financial picture of a major business or to find one number that will sum it all up. America's new requirement that Chairmen to attest to the truth of the financial statements may concentrate their minds wonderfully, but they can hardly be expected to double check the work of their own accountants and auditors.

If, however, the effect of this new requirement is that the accountability for truth-telling is passed down the line, some good may result. If a company took seriously the idea of a wealth-creating community with members rather than employees, then it would only be sensible for the results of their work to be validated by those members before placing them before the financiers, who might, in turn, have greater trust in their accuracy. And if the cult of the stock option waned with the decline of the stock market and companies decided to reward their key people with a share of the profits instead, then those members would be even more likely to take a keen interest in the truth of the financial numbers. It would seem only equitable, in fact, that dividends should be paid to those who contribute their skills as well as to those who have contributed their money, most of whom have not, in fact, paid any to the company itself but only to previous owners of the shares.

It may only be a matter of time. Already those whose personal assets are highly valued, people such as bankers, brokers, film actors, sports stars, make a share of the profits, or a bonus, a condition of their employment. Others, such as authors, get all their remuneration from a share of the income stream. This form of performance-related pay, where the contribution of a single member or a group can be identified, seems bound to grow along with the bargaining power of key talent. We should not ignore the examples of those organizations, such as sports teams or publishing houses, whose success has always been tied to the talents of individuals and who have had, over the years or even the centuries, to work out how best to share both the risks and the rewards of innovative work. In the growing world of talent businesses employees will be increasingly unwilling to sell the fruits of their intellectual assets for an annual salary.

As it is, a few smaller European corporations already allocate a fixed proportion of after-tax profit for distribution to the workforce. This then becomes a very tangible expression of the rights of the members. As the practice spreads it will then only make sense to discuss future strategies and plans in broad outline with representatives of the members so that they can share in the responsibility for their future earnings. Democracy of sorts will have crept in through the pay packet, bringing with it, one would hope, more understanding, more commitment and more contribution.

That may help to remedy the democratic deficit in capitalism but it won’t repair the image of business in the wider community. It might, in fact, be seen as only spreading the cult of selfishness a little wider. Two more things need to happen, may actually already be starting to happen.

The ancient Hippocratic oath that doctors used to swear on graduation included the injunction ‘Above all, do no harm.’ The anti-globalisation protesters claim that global business today does more harm than good. If their charges are to be rebutted, and if business is to restore its reputation as the friend not the enemy of progress around the world, then the chairmen of those companies need to bind themselves with an equivalent oath. Doing no harm goes beyond meeting the legal requirements regarding the environment, conditions of employment, good community relations or ethics. The law always lags behind best practice. Business needs to take the lead in areas such as environmental and social sustainability instead of forever letting itself be pushed onto the defensive.

John Browne, the CEO of BP, the oil giant, is one person who is prepared to do some of the necessary advocacy. He summarized his views in a public lecture on BBC radio. Business, he said, was not in opposition to sustainable development; it is in fact essential for delivering it, because only business can produce the technological innovations and deliver the means for genuine progress on this front. Business needs a sustainable planet for its own survival, for few businesses are short-term; they want to do business again and again, over decades. Many would now agree with him and are beginning to suit their actions to their words. Some are finding that there is also money to be made from creating the products and services that sustainability requires.

Unfortunately, the majority still see concepts such as sustainability and a social responsibility as something that only the rich can afford. For most, the business of business is business and should remain so. If society wants to put more constraints on the way business operates, they argue, all it has to do is to pass more laws and enforce more regulations. Such a minimalist and legalistic approach leaves business looking like the potential despoiler who has to be reined in by society and, given the legal time lag, the reins will always seem to many to be too loose.

In the new world of the knowledge economy, sustainability has to be further interpreted at a more human level, as concerns grow over the deteriorating work-life balance for key workers and the stress of the long hours culture. An executive life is, some worry, becoming unsustainable in social terms. One would have to be the modern equivalent of a monk, forsaking all else for the sake of the calling. If the modern business, based on its human assets, is to survive, it will have to find better ways to protect its people from the demands of the jobs it gives them. A neglect of environmental responsibility may lose customers, but a neglect of this type of social responsibility may lose key members of the workforce. More than ever, a modern business has to see itself as a community of individuals, with individual needs as well as very personal skills and talents. They are not anonymous human resources.

The European example – of five to seven week annual holidays, of legally-mandated parental leave for both fathers and mothers together with a growing use of sabbaticals for senior executives and, in France, a working week restricted to 35 hours (averaged over the year) – helps to promote the idea that long work is not necessarily or always good work, and that it can be in the interests of the organization to protect the over-zealous from themselves. Many French firms were surprised to discover that productivity increased when they were forced to implement the new reduced working hours. It is one manifestation of the concept of the organization as a community or, in its original and literal meaning, as a company of companions. The growing practice of individualized contracts and development plans is another.

More corporate democracy and better corporate behaviour will go a long way to alter the current business culture for the better in the eyes of the public, but unless they are accompanied by a new vision of the purpose of the business they will be seen as mere palliatives, a way to keep the world off their backs. It is time to raise our sights above the purely pragmatic. Article 14(2) of the German constitution states 'Property imposes duties. Its use should also serve the public weal.' There is no such clause in the American constitution but the sentiment has its echoes in some company philosophies. Dave Packard once said, 'I think many people assume, wrongly, that a company exists simply to make money. While this is an important result of a company's existence, we have to go deeper and find the real reasons for our being…. We inevitably come to the conclusion that a group of people get together and exist as an institution that we call a company so that they are able to accomplish something collectively that they could not accomplish separately – they make a contribution to society.'

The contribution ethic has always proved to be a strong motivating force in peoples' lives. To survive, even to prosper, is not enough for most. We hanker to live some footprint in the sands of time, and if we can do that with the help and companionship of others in an organization so much the better. We need a cause to associate with in order to provide real purpose to our lives. The pursuit of a cause does not have to be the prerogative of charities and the not-for-profit sector. Nor does a mission to improve the world make business into some kind of social agency.

Business has always been the active agent of progress, through innovation and new products, by encouraging the spread of technology, or lowering costs through productivity, by improving services and enhancing quality, and thereby making the good things of life available and affordable to ever more people. This process is driven by competition and spurred on by the need to provide adequate returns to those who risk their money and their careers, but it is, in itself, a noble cause. We should make more of it. We should, as charitable organizations do, measure success in terms of outcomes for others as well as for ourselves. Charitable organizations need money just as much as businesses do, but they talk more of their products and services and less of their financial housekeeping.

George C. Merck, the son of the company's founder, always insisted that 'medicine was for the patients not for profits.' In 1987, in line with this core value, his successors decided to give away a drug called Mectizan which cured river-blindness in the developed world, but which none of its sufferers could afford to buy.
The shareholders were probably not consulted, but had they been, many would have been proud to be associated with such a gesture. Business cannot often afford to be so generous to so many, but doing good not necessarily rule out making a reasonable profit. Maximising profit, on the other hand, often does deny one the chance to do the decent thing.

You can, however, also make money by serving the poor as well as the rich. As C.K. Prahalad has pointed out, there is a huge neglected market in the billions of poor in the developing world. Companies like Unilever and Citicorp are beginning to adapt their technologies to enter this market. Unilever can now deliver ice creams at just two cents each because it has rethought the technology of refrigeration, while Citicorp can now provide financial services to people, also in India, who only have $25 to invest, again through rethinking the technology. In both cases they make money, but the driving force was the need to serve these neglected customers. Profit often comes from Progress.

There are more such stories of enlightened business in both American and European companies, but they still remain the minority. Until and unless they become the norm, capitalism will still be seen as the rich man's game, interested mainly in itself and its agents. High-minded talent may start to shun it and customers desert it. Worse, democratic pressures may force governments to shackle the independence of business, constraining its freedoms and regulating the smallest details of its actions. Capitalism will have become corroded and we shall all be the losers.

"Myself and Other More Important Matters", by Charles B. Handy. AMACOM/American Management Association (February 28, 2008). ISBN-10: 0814401732
http://www.amazon.com/Myself-Other-More-Important-Matters/dp/0814401732/ref=p