

Conversations

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for tomorrow

Excerpt from
“Reimagining Capitalism in a
World on Fire” – Rebecca Henderson,
McArthur University Professor,
Harvard University

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SHAREHOLDER VALUE AS YESTERDAY'S IDEA

Rebecca Henderson is the McArthur University Professor at Harvard University, where she teaches the course on “Reimagining Capitalism.” Henderson spent the first twenty-one years of her career at MIT’s Sloan School where her research focused on the economics of innovation and on the question of how large organizations can reinvent themselves. Inducted into the American Academy of Arts and Science in 2018, Henderson is also a Research Fellow at the National Bureau of Economic Research. Henderson’s academic career is complemented by a deep engagement with the practice of management. She has been on the boards of Amgen, a Fortune 200 company, for eight years, and Idexx, an S&P 500 company, for fifteen. She has also consulted with a wide variety of companies including IBM, Motorola, Cisco, Nokia, Eli Lilly, BP, ENI, Unilever, P&G, and many smaller firms, and is routinely invited to speak to executives across the world.

What is capitalism?

One of humanity's greatest inventions, and the greatest source of prosperity the world has ever seen?

A menace on the verge of destroying the planet and destabilizing society?

Or some combination that needs to be reimagined?

We need a systemic way to think through these questions. The best place to start is with the three great problems of our time—problems that grow more important by the day: massive environmental degradation, economic inequality, and institutional collapse.

The world is on fire. The burning of fossil fuels – the driving force of modern industrialization – is killing hundreds of thousands of people, while simultaneously destabilizing the earth's climate, acidifying the oceans, and raising sea levels.¹ Much of the world's topsoil is degraded, and demand for fresh water is outstripping supply.² Left unchecked, climate change will substantially reduce GDP, flood the great coastal cities, and force millions of people to migrate in search of food.³ Insect populations are crashing and no one knows why – or what the consequences will be.⁴ We are running the risk of destroying the viability of the natural systems on which we all depend.⁵

Wealth is rushing to the top. The fifty richest people among them own more than the poorer half of humanity, while more than six billion live on less than \$16 a day.⁶ Billions of people lack access to adequate education, health care, and the chance for a decent job,

while advances in robotics and artificial intelligence (AI) threaten to throw millions out of work.⁷

The institutions that have historically held the market in balance – families, local communities, the great faith traditions, government, and even our shared sense of ourselves as a human community – are crumbling or even vilified. In many countries the increasing belief that there is no guarantee that one’s children will be better off than oneself has helped to fuel violent waves of anti-minority and anti-immigrant sentiment that threaten to destabilize governments across the world. Institutions everywhere are under pressure. A new generation of authoritarian populists is taking advantage of a toxic mix of rage and alienation to consolidate power.⁸

You may wonder what these problems have to do with capitalism. After all, hasn’t the world’s GDP quintupled in the last fifty years, even as population has doubled? Isn’t average GDP per capita now over \$10,000 – enough to provide every person on the planet with food, shelter, electricity, and education?⁹ And, even if you

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think business should play an active role in attempting to solve these problems, doesn't it seem, at first glance, an unlikely idea? In the majority of our boardrooms and our MBA classrooms, the first mission of the firm is to maximize profits. This is regarded as self-evidently true. Many managers are persuaded that to claim any other goal is to risk not only betraying their fiduciary duty but also losing their job. They view issues such as climate change, inequality, and institutional collapse as “externalities,” best left to governments and civil society. As a result, we have created a system in which many of the world's companies believe that it is their moral duty to do nothing for the public good.

But this mind-set is changing, and changing very fast. Partly this is because millennials are insisting that the firms they work for embrace sustainability and inclusion. When I first launched the MBA course that became “Reimagining Capitalism,” there were twenty-eight students in the room. Now there are nearly three hundred, a little less than a third of the Harvard Business School class. Thousands of firms have committed themselves to a purpose

larger than profitability, and nearly a third of the world’s financial assets are managed with some kind of sustainability criterion. Even those at the very top of the heap are beginning to insist that things have to change. In January 2018, for example, Larry Fink, the CEO of BlackRock, the world’s largest financial asset manager, sent a letter to the CEOs of all the firms in his portfolio that said the following: “Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.”¹⁰

BlackRock has just under \$7 trillion in assets under management, making it among the largest shareholders in every major publicly traded firm on the planet. It owns 4.6 percent of Exxon, 4.3 percent of Apple, and close to 7.0 percent of the shares of JPMorgan Chase, the world’s second-largest bank.¹¹ For Fink to suggest that “companies must serve a social purpose” is the rough equivalent of Martin Luther nailing his ninety-five theses to Wittenberg Castle’s church door.¹² The week after his letter came out, a CEO friend reached out to me to confirm that surely he didn’t – really – mean it? My friend was in a state of shock. He had based a long and successful career on putting his head down and maximizing shareholder value, and to him Fink’s suggestion seemed ludicrous. He couldn’t imagine taking his eye off the profit ball in today’s ruthlessly competitive world.

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It is possible to see the elements of a reimagined capitalism right now, and to see how these elements could preserve capitalism and make the entire world better off.

In August 2019 the Business Roundtable – an organization composed of the CEOs of many of the largest and most powerful American corporations – released a statement redefining the purpose of the corporation: “To promote an economy that serves all Americans.” One hundred and eighty-one CEOs committed to lead their companies for “the benefit of all stakeholders: customers, employees, suppliers, communities, and shareholders.”¹³ The Council of Institutional Investors (CII) – a membership organization of asset owners or issuers that includes more than 135 public pension and other funds with more than \$4 trillion in combined assets under management – was not amused, responding with a statement that said, in part:

CII believes boards and managers need to sustain a focus on long-term shareholder value. To achieve long-term shareholder value, it is critical to respect stakeholders, but also to have clear accountability to company owners. Accountability to everyone means accountability to no one. BRT has articulated its new commitment to stakeholder governance... while (1) working to diminish shareholder rights; and (2) proposing no new mechanisms to create board and management accountability to any other stakeholder group.¹⁴

One of the world’s largest financial managers insists that “the world needs your leadership,” and some of the world’s most powerful CEOs publicly commit to “stakeholder management,” while many businesspeople – like my (hugely successful) CEO friend and many large investors – think they are asking for the impossible. Which of them is right? Can business really – and I mean really – rescue a world on fire?

I've spent the last fifteen years of my life working with firms that are trying to solve our environmental and social problems at scale – largely as a means of ensuring their own survival – and I've come to believe that business has not only the power and the duty to play a huge role in transforming the world but also strong economic incentives to do so. The world is changing. The firms that change with it will reap rich returns – and if we don't reimagine capitalism, we will all be significantly poorer.

I started this journey with an appropriately British degree of skepticism, but I am now surprisingly optimistic – in the “if we work really hard, we might just succeed” sense of optimistic. We have the technology and the resources to build a just and sustainable world, and doing so is squarely in the private sector's interest. It is going to be hard to make money if the major coastal cities are underwater, half the population is underemployed or working at jobs that pay less than a living wage, and democratic government has been replaced by populist oligarchs who run the world for their own benefit. Moreover, embracing a pro-social purpose beyond profit maximization and taking responsibility for the health of the natural and social systems on which we all rely not only makes good business sense but is also morally required by the same commitments to freedom and prosperity that drove our original embrace of shareholder value.

A mere decade ago the idea that business could help save the world seemed completely crazy. Now it's not only plausible but also absolutely necessary. I'm not talking about some distant utopia. It's possible to see the elements of a reimagined capitalism right now, and to see how these elements could add up to profound change – change that would not only preserve capitalism but also make the entire world better off. •

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