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**AUCKLAND INSTITUTE OF TECHNOLOGY COMMERCE
STUDENTS BREAKFAST CLUB**

BUSINESS AS A VOCATION

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BUSINESS AS A VOCATION

A common demand is for businesses or their owners to 'give something back' to the community in which they operate. Youth Affairs minister Deborah Morris, for example, said in a speech last week:

Business gains from the community, and I feel that it is only right that it gives something meaningful back.

Such a statement sounds unexceptionable to many people. Even business people themselves, when engaging in acts of philanthropy, can sometimes be heard using precisely this language.

I would be the first to applaud acts of philanthropy by people in business, the professions and indeed all walks of life. But I believe it says a great deal about the widespread anti-business culture in our society that in justifying philanthropy some people should choose to employ – or feel obliged to employ – this language of giving back.

For the shared assumption in such statements is that businesses have taken from the community. If you take something, you have an obligation to repay. And there are many people who think that if you make money in business, it is automatically made at the expense of someone or something else – 'the poor', 'the community', 'the environment', 'the developing world'. There are many candidates for victim groups in the demonology of those who see business and private enterprise as exploitation.

Yet any such view is seriously mistaken. Markets are not characterised by exploitation and coercion, but by cooperation for mutual gain. In a market economy based on voluntary exchange within a clear legal framework you can only consistently make money in business by benefiting others. Given that reality, the whole idea of business needing to return something to the community constitutes either muddled thinking or intellectual dishonesty. As American George Leef, writing in the March 1998 issue of

The Freeman, bluntly but correctly observed:

Profitable businesses no more have an obligation to 'give something back' to 'the community' than 'the community' has an obligation to give something back to them – or to unprofitable businesses, for that matter.

Successful companies and individuals have already served 'the community', or to shed this useless abstraction, *people* in the community with whom they have voluntarily dealt.

Leef is right. The wealth earned by profitable businesses is earned by selling goods and services for which people are willing to pay. In an economy based on free exchange, both parties to any transaction expect to benefit. Whether it be buyer and seller, borrower and lender, or employer and employee, each party is making a trade, at a price that he or she calculates will leave them better off overall.

Profitable businesses are those that are successful in this ongoing process of cooperation and exchange. A typical business firm employs resources, such as labour and capital, and transforms them into goods and services desired by consumers. Firms that are particularly successful at benefiting consumers – whose goods are cheaper than those of their competitors, or of higher quality, or better adapted to consumers' requirements – make high profits and expand. Firms that are less good at meeting consumers' needs make low profits, lose customers, or go out of business altogether. Provided there is open competition, nothing compels anyone to buy the products of one firm rather than another: that decision will be made on the basis of which product provides the greatest benefit. In effect, firms are competing with each other over how best to serve the community. Competition and the profit motive are a spur to innovation: a market economy rewards and encourages innovation far more effectively than alternative economic systems. As wealth creation mechanisms, markets are unrivalled.

Thus if Bill Gates, for instance, spent part of his large personal fortune on philanthropic projects, it would make no sense to say he was giving something back to the community. The firm he created, Microsoft, has already improved the lives of millions around the world through its innovations in computer software. Mr Gates's personal wealth is one indication of the extent to which he has benefited others. Any

philanthropy he might engage in cannot possibly match in its impact the social contribution he has already made. And it will reflect his personal moral commitment, not a perceived obligation to 'give back'.

What I have just said about the creation of value through voluntary exchange and the benefits of competition is standard, orthodox, textbook economics. And it is borne out by observation: economies where market forces are given free rein easily outperform, over any reasonable period of time, economies where markets have been suppressed or marginalised as 'exploitative'. Yet the intellectual case for markets is still poorly understood by large numbers outside the business sector, and even by many within it.

One of the chief aims of the organisation I represent is to make the case for a competitive market economy in a well-researched, public and unashamed manner. The members of the Business Roundtable are chief executives from around 60 of New Zealand's largest companies. It does not apologise for consisting of a group of people who have responsibilities to tens if not hundreds of thousands of shareholders, policyholders, customers, suppliers and employees. Nor does it apologise for promoting open and competitive markets: it sees such markets as overwhelmingly in the interest of New Zealanders in general. Productive market economies especially favour the poor, who have the most to lose if a country has low incomes and high unemployment.

The charter of the Business Roundtable commits it to supporting policies that are in the overall national interest. Despite this, it is often criticised for acting in the narrow self-interest of its member companies. The accusation is seldom backed up by an examination of any policy we have promoted. We have supported what we believe sound economics suggests is necessary to achieve a growing, dynamic economy – first and foremost because that is in the interests of New Zealanders. At the same time, only such an environment will be good for business at large in the long run. Moreover, we have a demonstrated record of supporting many policies – like tariff reductions, deregulation of industries, and moves towards proper pricing of government services – which have been contrary to the immediate self-interest of many of our member firms.

The law on company takeovers is another example. Senior executives the world over typically favour restrictive takeover laws, since company managers' and directors' jobs may be put at risk by a takeover. Yet when the government proposed a restrictive takeover code, the Business Roundtable argued against it on the basis that it was not good for shareholders and the wider economy. Recently even the Business Editor of the *Herald* got it exactly backwards when he wrote that Douglas Myers had fought fiercely against a code "aimed at protecting small investors' rights." It is the interests of small investors, not those of incumbent boards and managements, that are best protected by an open market for corporate control. They cannot influence a company's direction, but the threat or reality of a takeover by larger investors certainly can. Shareholders in New Zealand companies have the option of voting for more restrictive takeover rules, but only in the case of a handful of companies have they decided that restrictions would be in their interests.

This puts policies promoted by the Business Roundtable in sharp contrast to those proposed by many business groups abroad. The constant temptation of people in business is to lobby governments for special treatment for their own industry, for example through a subsidy or the restriction of competition. There is always an argument to be made that such assistance will create jobs, save foreign exchange, benefit a region, or promote a new technology. But assistance to one industry is inevitably at the expense of others. And of course more than one industry can play this game, so the public policy debate all too quickly degenerates into an unedifying struggle over who can secure the most government privileges. The businessman playing this game can hardly be said to be benefiting the community. By actively promoting bad policies and becoming a supplicant for corporate welfare, he becomes the miserable figure Ronald Reagan once described as the fellow who hoped the crocodile would eat him last.

That is actually quite a good description of much of the activity of New Zealand business organisations during the Muldoon era. It was greatly to the credit of Sir Ronald Trotter, the Business Roundtable's first chairman, that he recognised that

business people needed to put aside their obsession with sectional interests and instead promote policies that were in the general public interest. This meant supporting the broad thrust of the country's economic reforms, and urging that they be extended into areas of the economy not yet liberalised.

During this time the Business Roundtable, and big business generally, have come in for plenty of criticism – some of it virulent, much of it ill-informed or based on emotion rather than logic. One criticism is that we ignore the wider 'social responsibility' of business. It is claimed that public companies should do more than just maximise their long-term profits by serving consumers' interests well. Companies, it is said, should give away shareholders' money to worthy causes in the community. And they should balance the interests of various so-called stakeholders – such as customers, suppliers and employees – alongside those of shareholders. Both of these arguments are currently being promoted by businessman Dick Hubbard in his criticisms of the Business Roundtable.

On the first count, it is simply not true that it is the role of the directors and employees of a company to give shareholders' money to charity, if the donation is not in the company's own interests. The legal situation is quite clear. Directors are stewards of shareholders' financial interests. They are entrusted with shareholders' money, and it is not theirs to give away. As lawyer Geof Shirtcliffe has recently written, the fact that directors may consider the charity to be a 'good cause' makes no difference to their fiduciary duty. Dr Elaine Sternberg, the author of *Just Business: Business Ethics in Action*, has put it this way:

Managers who employ business funds for anything other than the legitimate business objective are simply embezzling: in using other people's money for their own purposes, they are depriving owners of their property as surely as if they had dipped their hands into the till.

A member of the public summed up the issue well in a letter to me when he wrote: "Mr Hubbard will have to learn to distinguish between charity (coming from the individual) and a chairman's tax on shareholders." Decisions about charitable giving are properly for individuals – shareholders or others – to make. And it is up to each of us to decide

which causes and what civic associations we voluntarily support. After all, we live in a free society with a plurality of values and a wide range of legitimate interests.

The tendency to attribute to abstract entities – such as the corporation, 'the nation', 'the government' or 'society' – responsibilities that properly belong only to individuals is woolly thinking. It is a delusion which has spawned many wrong and oppressive policies, with the totalitarian regimes of our own century being just one example. Moreover, its effect on the fabric of civil society is almost always negative. It leads to a culture of diminished responsibility, and weakens our dignity and integrity as free, thinking and autonomous persons.

Thus the role of company directors and executives, who are the agents of shareholders, is to maximise the long-term value of the business – in ways that are within the law and consistent with ethical standards. Their role is not to second-guess the causes on which you or I might like to spend our money if, as shareholders, we have entrusted them with our funds. That can only be our decision.

Of course there are sometimes sound business reasons for a company to support a charity. If the company receives favourable publicity, the donation might legitimately be seen as advertising. An acid test is whether a company would make a contribution to charity anonymously – knowing it could not benefit the company. If so, it is a tax on shareholders. If not, it is a public relations exercise with a commercial goal.

In addition, directors need not have a prime goal of maximising profits if other objectives are part of the explicit purpose of the company. The Body Shop is an example of a company with a range of social objectives. It is an entirely legitimate vehicle for those who support its purposes, but such companies should not be confused with others which have no such mandate.

The broader claims about stakeholding suffer from similar confusions. On one level those who promote 'stakeholder' models are saying something to which few would object. If they are simply asserting that business firms need to take the interests of

various stakeholders into account, then the claim is obviously true. For instance a company exists for, and relies on, its customers. If it fails to see them as real people with real needs, and to treat them as such, it will not be successful for long. Similarly, a company relies heavily on the quality of its employees. To get the most out of its workers, it must treat them with respect and have strategies to encourage motivation and team spirit.

The Business Roundtable has been accused by Mr Hubbard of denying such elementary rules of good business practice. He has said: "I strongly disagree with the approach of the Business Roundtable that labour is merely an 'ingredient' or an 'input' to business, the cost of which must be minimised as much as possible to maximise profits."

I would invite you to consider how impressed you would be if, as a student, a firm on a recruitment drive said to you: "Come and work for my company and we'll treat you merely as an ingredient to our business. You'll be an input. Of course we'll want to keep your cost to an absolute minimum, so as to maximise our profits." Not, I suggest, a great recruitment strategy – or an idea that any sane person would entertain, let alone implement.

So we can all agree that good firms put a lot of effort into treating their various stakeholders well. They may well implement remuneration arrangements related to the performance of the business, or adopt other schemes for sharing risks and rewards. But a critic such as Mr Hubbard goes further and argues that post-tax profits should be distributed to groups such as employees and the community.

Such ideas have a long history. Stakeholder theory so defined is a version of socialism – though a rather fuzzy version. It is not dissimilar to the ideas behind the workers' cooperatives in Tito's Yugoslavia; it was trendy at one point to claim that they were models for peace, prosperity and mutual understanding. The reality is that such concepts are incoherent because they offer no principled guidance on how the competing demands of stakeholders can be met, let alone reconciled with the demands

of the company's owners. All sorts of actions affect the various stakeholders to varying and often opposite degrees.

Imagine for instance that a firm lowers the price of a good it is selling. That may be good for consumers but bad for the firms' employees and suppliers if the firm becomes less profitable. Or suppose a firm decides to continue running an unprofitable operation employing outdated capital equipment because it wants to maintain the jobs of people working in that plant. That may be good for the employees immediately involved, and for the particular region. But it may be bad for consumers and for communities elsewhere: the alternative may have been new investment in a plant that produced cheaper or better quality goods, and provided more numerous or more highly paid jobs. If we throw the profit motive and the price mechanism overboard, there will simply be no reliable compass to guide us in making such decisions.

Indeed the whole concept of 'stakeholder' is so slippery of definition that it is almost infinitely expandable. For instance, the firm that decides to keep its uneconomic plant operating will earn less profit. Are not you and I, as taxpayers, affected by this decision and thus stakeholders in it? The firm will pay less tax. This means more tax from the rest of us. Or marginally higher interest rates for borrowers, if the deficit is met by government borrowing. Or savers being punished through the inflation 'tax', if the shortfall is met by printing money. Some group of people, somewhere, will be harmed by the firm's action. Are not they entitled to be called stakeholders too, and have a say in the firm's decision? The fact is that in a modern market economy virtually everybody is affected – if only marginally and indirectly – by the significant economic actions of others.

Once we are at this point we may be encouraged to press on to full-scale socialism. Or, more rationally and less disastrously, we may realise that we have been chasing a will-o'-the-wisp, and that a model of a public corporation based on the notion of balancing 'stakeholder' interests simply makes no sense.

It is worth noting that New Zealand's state trading organisations prior to their corporatisation amounted to a version of the stakeholder model. Profits were often subordinated to other objectives such as providing make-work employment and keeping prices to households at artificially low levels. As usual when there are multiple and conflicting objectives, there was no real accountability. Not surprisingly, the organisations were notoriously inefficient. Hardly any mainstream commentators these days claim that this was a sensible arrangement for the state sector, or urge that we return to it. Why then should we take the idea any more seriously when applied to the private sector?

There is a an even more fundamental problem with any serious attempt to pursue stakeholder theory – the moral corrosion and deterioration in social cohesion that is likely to result. The whole language of stakeholding is of entitlement: various groups are encouraged to see themselves as entitled to share in the rewards of the firm, or of society generally. But as we have just seen, there is no rational way of deciding upon various competing claims, and the demands of various groups on the basis of their perceived 'needs' are unlikely to be compatible with one another. Thus the in-built dynamics of a stakeholding society are likely to lead to increasing faction and intrigue. As the theologian Michael Novak has written in his latest book, *The Fire of Invention*:

Schemes of social belonging usually end up with populations far too accustomed to receiving and demanding. Those most skilled at mobilising demands fare best. While social democracy speaks the language of community and compassion and caring, the reality is original sin, that is, socialised self-interest. Social democratic societies are not notably happy or contented societies [W]hile extolling the language of community and social sharing, social democracy necessarily excites envy, a social passion worse than hatred, and it inevitably divides citizens into factions that make on the state unceasing claims of favour, entitlement and privilege.

It is important that we distinguish claims made on the basis of compassion for the poor and disadvantaged from claims made on the basis of envy for the rich. Those who profess to care about the poor should defend and promote the market economy: well-functioning markets are powerful mechanisms for generating and spreading wealth, and in the process raising up the poor. The worst type of apologist for business is the

one who fails to make the case for markets competently, and instead misconstrues the social responsibility of business. As Milton Friedman puts it, "Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society. They only spread ignorance, envy and confusion."