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The Survival of Capitalism: Supporting Communities to Stare Down National & Global Threats

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With communities and businesses alike being confronted with sustainability challenges on multiple fronts, the imperative of communities being in control, and the critical role of business in this, needs urgent attention.

The evidence is clear. If we don't change our ways, the future of our society remains increasingly uncertain, and not just from human triggered climate change.

At the same time, with public trust in the actions and intent of big business at an all-time low, the future of capitalism as we know it is under question.

But it is not all bad news. The world has been getting better economically and socially, not worse, as the anti-globalisation movement would have us believe. While the extremes are widening, global incomes are becoming more equal and a bulging middle class is emerging. More importantly, the proportion of the global population living in extreme poverty (on less than \$1 per day) has dropped from 28% in 1990 to less than 20% just a decade later. There has also been an overall expansion in political and civil freedoms.

Nevertheless, the current times remains particularly challenging for the future of communities and for business.

In the suburbs and the regions, people are feeling the stresses and strains, and they're feeling a real sense of powerlessness and a loss of control.

Understandably, there is a growing desire within communities to get greater control of their own destinies again.

Yet inside the corporate walls, it feels like another world, another reality; a world where, too often, these community concerns and sustainability challenges are simply viewed as someone else's problem – a distraction from the business of business.

Broader societal concerns struggle to penetrate the corporate veils, often shunted aside and ignored in favour of short-term profit and shareholder wealth maximisation.

Many, too many, companies seem to operate on the premise that *'the business of business is business – and only business'*. The externalities of business activities are simply left for someone else's care.

But if communities are to be in control, and they need to be, then the social goods necessary for a functioning and sustaining society must be cared for and nurtured. And when the economic power of corporations is growing ever larger, and that of government ever weaker, we simply can't afford to have a large part of the corporate world detached from or seemingly at odds with this need.

No-one should be too surprised that the role of business in society is now firmly in the spotlight and that the concerns of citizens, which have been largely frozen out, are finding new voice.

Attention is again being focused on the central question – the central question that has been on the table ever since the father of capitalism Adam Smith wrote his *Wealth of Nations* in 1776. Is it possible for corporations to deliver on their fiduciary responsibilities to shareholders and at the same time serve the public interest in contributing to human, social and environmental capital?

Or to put it more bluntly, will the unfettered pursuit of corporate profit, without adequate attention to the public good, ultimately set crippling and unnecessary limits on capitalism and our society, making it less creative, less equitable, less dynamic, and less sustainable?

What is not widely understood is that Adam Smith in fact described a system based on 'enlightened self interest' and not one based on personal advantage at the ultimate expense of the common good. In his earlier work, *The Theory of Moral Sentiments* in 1759, Smith underpinned his 'capitalist' system with the virtues of justice, fairness and honesty. Smith saw neither selfishness nor greed as virtues and regarded the spheres of human conduct – economic, social, moral, and political – as interwoven and mutually dependent. Societies function best, Smith argued, when economic and ethical interests coalesce.

So how did so much of today's corporate behaviour end up being at odds with that envisaged by the father of capitalism?

At least part of the answer can be traced back to the early influence of Social Darwinism – a philosophy whose essence is that human societies function best when the principle of ‘survival of the fittest’ is exercised to the maximum extent. Following this philosophy, a ‘laissez faire’ form of capitalism soon dominated, built on the belief that the market works best if unfettered by regulation or externally imposed obligations. While its popularity dipped somewhat with the socially unpleasant consequences of depression and war, it has made a resounding recovery in the last few decades.

The latter day Social Darwinists now unite behind the ‘shareholder primacy principle’ to reject ideas of corporate responsibilities extending to civic, common good or other stakeholder responsibilities.

At the same time, they actively seek even greater autonomy in decision making despite what has already been a major shift in power from the true owners, the shareholders. At the extreme, they argue that fiduciary responsibilities and the law actually prevent them from considering the interests of stakeholders beyond shareholders.

But the corporations’ law contains no such legal constraint nor does it contain any legal obligation to maximise profits or shareholder wealth – and certainly not in the short term at the expense of longer term interests.

The legal obligation on directors, in fact, is to manage the company ‘*in good faith*’ and ‘*in the best interests of the corporation*’. And their common law fiduciary responsibility is to act ‘*in the interests of the company as a whole*’.

But the latter day Social Darwinists typically misrepresent these duties as an obligation to act in the best interests of shareholders alone, thereby excluding the interests of other stakeholders such as employees, customers and the broader community.

The problems with this rather narrow and brutish form of capitalism are several. First, the so called ‘agency problem’ arises whereby the growing gap between the interests of the owners and the managers creates a vacuum of real ownership and the inevitable governance problems. And second, narrow self-interest and personal advantage inevitably get elevated to the status of core values.

Little wonder that stories of corporate scandals, frauds, accounting deceptions, sub-prime crises, and so on, continue to unfold, all of them powered by outlandish greed and lack of ethics and such stunning disregard for the public interest. One might wonder if those involved even recognise that such a thing as the public interest existed.

The unfortunate thing is that all business tends to get tarred with the same brush, and hence the widely held public view that all big business is naturally opposed to the public good. But this is a position that certainly does not accord with the actual practices of a great number of companies. And it is a position that is not sustainable.

The confusing and often misunderstood language of corporate responsibility has also not been helpful. Implying something foreign to the normal course of business – something of an optional extra – it has provided a convenient escape hatch for those not wanting to be held accountable for the social and environmental blowbacks from their corporate activities.

At its core, however, corporate responsibility is all about enlightened self interest. Enlightened in the sense that the interests of all stakeholders are considered and responsibility for the externalities of business activities accepted. It involves an understanding that business, and its interests, can't be separated from the society in which it operates and on which it depends.

Confusing and misunderstood as it might be, the recent emergence of corporate responsibility – or what is better described as responsible capitalism – does stand in stark contrast to this somewhat harsh and unbridled form of capitalism that has increasingly prevailed over recent decades.

Having arrived at this confronting and worrying crossroad for business and society, which path will business take?

Will the corporate world opt for a more responsible, dynamic, creative and sustainable form of capitalism? A form where corporate leaders willingly lead beyond their institutional walls? A form where corporations readily accept accountability for the impacts of their business activities that affect the public interest, and where they actively contribute to building community and hence the common good?

Or are new corporate laws and regulations the only way to ensure that the public goods required for social justice and for a prosperous society are nurtured, as Robert Reich argued in his book *Supercapitalism*. Do governments need to get beyond the rhetoric and play a stronger, more active role in dictating responsible business behaviour by intervening in the market place whenever a societal case can be made?

The problem with laws and regulations, however, is that they can be clumsy and blunt, typically targeting the lowest common denominator, and often seeking to close the barn door after the horses have bolted.

Or will community-led activism be necessary to ultimately drive the needed step changes and action in corporate responsibility and sustainability?

The warnings are clear. Doing nothing is not an option – at least not an option if business wants a prosperous and sustainable future.

The great management thinker Peter Drucker didn't mince words when he said that unless the common good is adequately looked after – and corporations must be a big part of this – our society ultimately risks destroying itself, just as all earlier pluralist societies destroyed themselves.

But fortunately – standing at this challenging business and society crossroad – we can also see positive and helpful signposts. A growing number of companies have shifted or are shifting their mindsets and rediscovering the true role of business in society.

Progressive companies are out there raising the bar through new coalitions, groupings and initiatives. Initiatives such as the Extractive Industry Transparency Initiative, the Equator Principles, the Forestry Stewardship Council, the Principles for Responsible Investment, the Ethical Trading Initiative, and the Australian Business Roundtable on Climate Change, to name a few.

Companies that have voluntarily driven such initiatives see the societal and business threats and the paradigm shifts underway and they want to be ahead of the game.

Even the folk hero turned corporate monolith, Wal-Mart has come on board. On the back of the aftermath of Hurricane Katrina, Lee Scott, the CEO of Wal-Mart, spelt out a new leadership for Wal-Mart in the 21st century. Environmental impact, community involvement, workforce practices and responsible sourcing were the new gateways for Wal-Mart becoming the most competitive and innovative company in the world. It was a major change in stance.

A further signal of the growing revolution in business thinking was found in the July 2006 issue of *Fortune* magazine. The magazine ran a piece titled *The New Rules*, claiming a dramatic rethinking was underway about the fundamental drivers that had defined corporate success over the past few decades. *Fortune's* new rules are more about being agile, finding niches, looking out not in, and the premise that the customer is king – and not the shareholder – although of course shareholder interests remain fundamental.

Nothing captured the shift more than new rule seven. The old rule was *Admire my Might*; the new rule is *Admire my Soul*. Having a 'soul', *Fortune* stated, is all about "defining a company's vision in a sustainable, long-term way – and to hell with what the hedge funds or other pay-me-now investors say".

The sustainability of capitalism in its current guise was already coming under scrutiny from surprising quarters. Bill Emmott, the then editor of the *Economist* magazine, summed up the growing concerns when he declared that whether "*capitalism will survive*" was one of the most crucial questions for the 21st Century. Emmott identified four flaws threatening its survival; namely that capitalism in its current form was "unpopular," "unstable," "unequal" and "unclean". It was not a great scorecard.

Boards certainly should have started listening when the *Economist* magazine itself featured an article titled '*Pigs, pay and power*' claiming that executive pay lay at the heart of capitalism's troubles.

As we have come to know it, however, modern capitalism makes no claim to providing an equitable distribution of income and wealth. Nor, of itself, does it care much for the environment – its basic impulse is 'creative destruction'.

But when pushed or threatened, people care mightily about equity and fairness – and the environment – and they are prepared to trade economic efficiency for it.

This matters to business because in any functioning democracy, the community 'licence to operate' is up for continual renewal. And ultimately the community's voice gets heard. This means corporations need to demonstrate that in accepting the massive transfer of power from the public to the private sector they successfully fought for over the past 25 years or so, they also accept the additional responsibility that comes with it.

Specifically, corporations need to show they will use that power responsibly with due regards for the interests of the entire community who grant their social licence to operate. Community trust that they will do so has clearly not yet been won.

So where to from here? How do corporations fully restore community trust and how do they successfully play their part with local communities in staring down these sustainability challenges?

For a start, a more moral form of capitalism needs to be widely adopted – one where the interests of the firm are reconciled with the public interest. A form where, in the pursuit of the corporate interests, the public interest is not lost, and neither are the principles of right and wrong.

Or, to use corporate-speak, a form where the concept of corporate value reconciles the needs of the owners of the capital with those of the relevant stakeholders on which the ongoing viability of the business depends, including the broader community.

This is very doable and progressive companies are actively demonstrating that recognising and embracing concerns for the impacts of their corporate activities on the public welfare does not compromise their profitability.

In accepting accountability for the externalities of their business activities these companies are finding that they are taking risk out of their business, enhancing their 'social licence to operate', and thereby adding to shareholder value.

To put it another way, these companies have managed to find that wonderful point of equilibrium that successfully blends their corporate self-interest with principles and values that accord with broader stakeholder interest.

As Adam Smith would have put it, they have managed to put '*self-interest considered upon the whole*' into true practice.

Were all firms to recognise this and make the necessary effort, capitalism would be a more sustainable system; if anything, a more efficient one and certainly one more uniformly admired.

Encouragingly, there is now a growing view in equity and investment markets that this is the right strategy. The message is becoming increasingly clear: the pursuit of excellence in business does not require companies to forget their moral sense and the related risks. Companies can do good and do well at the same time.

The smart and progressive companies have realised that they can't sustainably prosper in societies that are failing. And they have realised that to have prosperous and thriving high streets, you also have to have prosperous and thriving back streets. They go hand in hand.

Or to put it another way, they have realised that they need more than strong financial capital. They also need strong human, social and environmental capital. They realise that they cannot expect to sustainably increase their profitability if the so called 'intangible value drivers' of employee commitment, innovation, brand reputation, customer satisfaction, and environmental management, to name only a few, are not properly managed.

Unfortunately, accounting conventions do not readily embrace such non-financial value drivers. Too often, managers simply overlook or undervalue them as a result. So the second thing needed for responsible capitalism is for the concept of corporate value, and the related accounting conventions, to better embrace the full spectrum of both financial and non-financial capital.

Thirdly, in order for the global business community to operate more ethically and morally there need to be commonly accepted principles and standards.

A decade ago, the Caux Round Table codified a set of principles and guidelines for activating a moral sense in business. The Caux Round Table's *Principles for Business* initiative was followed in 1999 by the United Nations' *Global Compact* – 10 principles defining responsible corporate citizenship covering the areas of human rights, labour, the environment and anti-corruption.

Today, around 4000 corporations have signed up to such principles. But many more have yet to publicly embrace these standards of behaviour and ethics that are so fundamental to social inclusion, strong communities and sustainable prosperity.

Fourthly, if we are to sustain the prosperity of our companies and our society, more of our business leaders are going to have to move beyond the walls of their institutions and truly learn to create community.

Adam Smith was right when he implied via his '*invisible hand*' that the intention of free and autonomous individuals would lead regularly and reliably to socially beneficial results. But strong leadership from both business and political leaders is needed to create the conditions for free and autonomous individuals within business and within society.

What is also not as widely understood as it should be is that economic activity is co-operative activity. The best capitalism consequently involves co-operative activities, ethical principles and values that respect stakeholder interests.

All of this will require innovation in corporate thinking including around community partnerships, so that the vital goal of strong communities and sustainable prosperity can be secured.

The Westpac story over the past decade provides a compelling example of how this all plays out. It provides an example of how social concern, environmental sensitivity and innovation can lift a brand beyond the conventions of an industry and deliver more sustainable returns and improved public outcomes.

In the early 1990s, Westpac was waking up to the growing realities of an ageing population, the inevitable war for talent, the increasing stresses of

two-income households, and the related challenges for their employees in balancing work, home and carer responsibilities.

The inherent workplace and employment risks to Westpac were clear, as were the broader societal issues. After all, workplace practices can play a big role in contributing to or detracting from social capital across the community.

Seizing the opportunity to take leadership in implementing workplace reforms, Westpac introduced paid maternity leave in 1995. This was followed by paid adoption leave in 1997 and then paid paternity leave in 1998. Extensive workplace child care and other child care support initiatives were also implemented.

Not only did these initiatives materially lift employee moral, commitment and retention they also delivered material community benefits in contributing to social capital. In fact, without them one can argue Westpac would not be as well positioned as it is today.

They were very positive for Westpac's bottom line. In the early '90s, Westpac's return to work rate for women following pregnancy was around 30%, adding to a relatively high employee turnover rate across the company. The return to work rate is now consistently in the high 80s to 90% and Westpac's employee turnover rate is consistently around two percentage points below the industry average.

When you consider that it costs Westpac conservatively an average of \$50,000 or more to recruit and train a new staff member, not to mention costs from the loss of experience and so on, the business case was obvious. Savings, or avoided costs, in excess of some \$50 million per year resulted.

A more current example has been Westpac's actions on climate change. In April 2006, together with the five other companies and the Australian Conservation Foundation, Westpac released the Australian Business Roundtable on Climate Change report. The report called for urgent action to deliver large emission reductions including the introduction of a market-based carbon pricing mechanism.

Being prepared to stand up against the prevailing government and business views at the time was a pretty lonely space. But supported by

others willing to speak out, other reports supporting the case for urgent action, and the undeniable science, by June 2007 this had become bipartisan policy. It demonstrated that business can do all sorts of things when it leads.

A further important aspect has been Westpac's community contributions initiatives. The global best practice aspiration of investing 1% of pre-tax profits in community based initiatives has been well-established for some time and several Australian companies, including Westpac, meet this standard. Last year in fact, Westpac's community contributions in Australia totalled some \$52 million, or 1.3% of its Australian pre-tax profits.

Assisted with paid time off to volunteer, in excess of two thirds of Westpac's employees regularly volunteer in the community. Last year, employees also personally donated in excess of \$1 million to Australian charities which was dollar matched by Westpac. Since Westpac's Matching Gifts program was started in the late 1990s, some \$15 million has now gone out to 1100 charities through the individual efforts of Westpac's employees.

A key part of Westpac's community contribution is in the form of community partnerships across the community and welfare sectors, indigenous enterprise, rescue services and so on.

Westpac's Community Partnership program is based on the premise that a bigger impact on society can be made by working closely with key community groups over the long term, and by using Westpac's network resources and the skills and expertise of its people.

The Westpac example demonstrates the sort of leadership that builds community and encourages faith in the capacity of business to play a leading role in strengthening communities and caring for the common good.

The clear message from the Westpac story and from the many others that could have been used is that the pursuit of excellence in business does not require capitalism to forget its moral sense.

After all, the links between stakeholder-responsive practices and shareholder value are pretty obvious and are particularly evident through:

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improved reputation capital, with both employees and customers; enhanced social licence to operate; reduced regulatory and other operational risk; greater operational efficiency; and more rapid responsiveness to changing societal trends. All of which go to enhancing shareholder value both today and into the future.

It is no surprise that corporations in the top decile of the Dow Jones Sustainability Index, such as Westpac, deliver on average over 50% greater return on invested capital than companies in the bottom decile of the index.

The evidence is there that corporations that out-perform in managing environmental, social and governance risks, and that actively contribute to human, social and environmental capital, also typically perform strongly financially. In any event, corporations will ultimately have little choice but to adopt a more responsible form of capitalism.

It is clearly in corporations' intelligent self-interest to act. To appreciate why, one needs to look no further than the regulators' response to the business world's ostrich-like reaction to earlier corporate excesses and governance failures. Community outrage at corporate inaction was inevitably followed by highly prescriptive governance and costly disclosure requirements.

Surely business will be clever enough to regulate itself this time around, and clever enough, one would hope, to see the upsides not just for itself but also in ensuring strong communities.

Just as readily, business can be a big part of the solution to national and global threats, rather than simply being just a big part of the problem.

The path forward from the current crossroad for business and society is clear. Business must show the innovation and foresight to take responsible and moral capitalism from the fringes of the business model and firmly entrench it in the heart of everything it does, as Adam Smith, the founder of capitalism, intended.