

# Recovering Moral Purpose in Capitalism

*To honour the memory of Richard Turnbull, former Director of the Centre for Enterprise, Markets and Ethics, who died recently, FiBQ is republishing his essay exploring the tensions between faith and contemporary capitalism.*

## What's in a name?

Capitalism is a complex word, even inadequate. Marxism uses the term in contrast to 'labour'. It assumes that the accumulation of capital can only be at the expense of labour, a zero-sum game. Economic theory holds capital to be one of the 'factors of production', with land, labour and entrepreneurship, which at least allows for economic growth. Capitalism, at least in the public mind, may be linked with the opportunities, personal responsibility and individual freedom that lead to wealth creation, or with greed, lack of opportunity and inequalities that may lead to poverty – sometimes both in the same survey.

There are many dilemmas. The globalisation of world trade has extended the benefits of growth, not least reductions in global poverty, but not only is the growth shared unevenly, the exclusion of many from the benefits leads to alienation. Oligopolistic markets that lack real

competition are not really capitalism at all. Neither are public bailouts for failed businesses – even banks; more like socialism for the already wealthy.

So for some, the recovery of moral purpose in capitalism is an oxymoron. Nevertheless, the fact remains that it is the capitalist economic system that, for all its failings, delivers goods and services, well-being of individuals and communities, provides employment and opportunity and encourages enterprise and entrepreneurship. The recovery of moral purpose for capitalism, rather than being a contradiction, is the essential prerequisite for its effectiveness.

Therefore perhaps capitalism is the wrong word to describe an enterprise, market-based economy built on values of purpose, service and integrity: in other words an economy with values shaped historically by the Judaeo-Christian ethic, encompassing growth, reward, incentive and opportunity, but also fairness, responsibility and compassion as integral elements.

Yet capitalism is here to stay.

Adjectives such as inclusive, conscious, restorative and relational have all failed to capture the imagination. What capitalism needs is not a new definition, but the restoration of moral purpose in markets, in business purpose, conduct and structure and, indeed, in the character of market participants.

## The merits of capitalism

The contours of capitalism include its merits, as well as its failings and its relation to faith. At the heart of the moral case for enterprise and capitalism is, first, *the necessity of wealth creation for the economic and moral well-being of society*. The most effective mechanism for achieving the economic growth necessary for the common good is the market economy. This is the means for the provision of goods and services, the management of savings and investment, the encouragement of the propensity to save, the provision of employment and a tax base.



A second crucial element to capitalism is *freedom to trade and undertake economic activity*. The market brings buyer and seller together, who trade, to mutual advantage, at the agreed price. In *A Splendid Exchange* William Bernstein tells the extraordinary story of trade and the resulting mutual benefits: 'World trade has yielded not only a bounty of material goods, but also of intellectual and cultural capital'.<sup>1</sup>

Both these points, which are all too frequently lost in debate, are reinforced by Milton Friedman's observation in *Capitalism and Freedom* that he knew of 'no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organise the bulk of economic activity'.<sup>2</sup>

Third, *the propensity to save*. The importance of savings – deposits, investment funds, life and pension funds – is often overlooked. The efficient pooling and investment of this capital in high-quality, innovative companies, technological advance and product development is an essential driver of growth and employment in an enterprise economy.

## The failings of capitalism

The market is an efficient mechanism but it is not perfect. There are problems of monopoly, oligopoly, price fixing and the fact that the market is populated by individuals who are themselves not perfect but flawed. In the same way that the benefits of the market cannot be ignored, neither can its imperfections. Similarly, economic growth may accrue unevenly. Thus the market may lead to inequalities. Equality is not a goal *per se* – but extreme inequalities reinforce the loss of opportunity in an economy, significantly dampen aspiration and may result in lack of access to justice or the other basic institutions of civil society.

The first problem lies then in *the failure of competitive markets*. So, for example, in both banking and energy sectors in the UK, the market is dominated by a small number of large players. The consequence of this is that price competition is reduced, consumer choice may be limited and there are significant barriers to entry and the potential for restrictive practices. Reduced choice and high prices disproportionately affect the poor.

The second problem is the painful consequences of *reallocating capital*. The impact of the movement of capital from a dying or declining industry into new areas of growth has significant and negative structural impact. This may be true in terms of unemployment, the knock-on effect on consumer spending, issues of poverty and structural decline of communities.

## **'This perception of corporate greed is further reinforced by apparent rewards for failure, excessive remuneration and failings in corporate governance.'**

The third issue is the *exploitation of power* often seen in examples of corporate and personal greed. This perception of corporate greed is further reinforced by apparent rewards for failure, excessive remuneration and failings in corporate governance. All of

these things underline the sense of 'crony capitalism', the accumulation of capital by the few, and greed.

The point is that a combination of capital accumulation, globalisation of production, structural decline in industries and failings of corporate governance, combined with greed and malpractice, produces effects that cannot be ignored.

## Capitalism and faith

The market economy has always attracted people of faith. The reasons are, of course, varied. Sociologists will point to the 'Protestant work ethic' and the formation of what Max Weber referred to as 'the spirit of capitalism'

in the title of his famous work. In other words, Protestants worked hard for the Lord in the world, their faith of individual discipline shaping a work ethic. For others, such as the Quakers, persecution and exclusion from the universities and from public office meant that many turned not only to business *per se* but also to technological research and development. Quaker involvement in manufacturing and banking went considerably beyond their numerical influence. It is quite extraordinary how many of our companies – Cadbury, Barclays, Huntley & Palmer, Clarks – had Quaker origins. The Quakers produced 'advices on trade' over many decades, warning against everything from overtrading to indebtedness and advocating the priority of good accounting. They made provision for the welfare of their employees – from sick pay to pensions; from savings banks to model housing.

However, these explanations are only partial. Two other factors have formed and shaped how people of faith have influenced business. First, the development of culture. People of faith have often formed networks of families, contacts, even schools and so on. These factors led to a culture of trust and integrity in business dealings. Trade networks, credit finance and apprenticeships all developed through these culturally shaped groupings. In addition to that, most religiously minded people had clearly developed moral codes – for the Christian most usually the Bible – and as a consequence, habits of moral behaviour (honesty) also translated into business practice: fair pricing, resistance to bribes, weights and measures and indeed concern for employees and wider society.

Faith provided, for some though not all, a framework of culture and conduct. Both of those aspects of a moral, purposeful, inclusive business ethic are today often sadly lacking.

## The changing nature of business purpose

In 1987 one of the leading chemical conglomerates at the time, ICI,



described its purpose as follows: 'ICI aims to be the world's leading chemical company serving customers internationally through the innovative and responsible application of chemistry and related science. Through the achievement of our aim we will enhance the wealth and well-being of shareholders, employees, customers, and communities which we serve and in which we operate.'

In 1994 the company objective had changed to: 'Our objective is to maximise value for our shareholders by focusing on businesses where we have market leadership, a technological edge, and a world competitive cost base.'

So what changed? What changed so that ICI no longer aimed to be 'the world's leading chemical company' with commitments to 'employees, customers, and communities which we serve'? As John Kay argued in *Obliquity*, 'shareholder value maximisation' has become the single measure of business return.<sup>3</sup> Continued adherence to this mantra imperils the future of the enterprise economy.

Profit – the surplus of revenues over costs, the value added to goods in the process of manufacture and sale – is a deeply moral concept. Profit is essential to the proper, effective and long-term functioning of a business. However, profit is essentially a by-product of purpose. When profit is sought in the context of purpose, it brings value to our ever globalised, ever competitive marketplace in a

manner that continually strives for a goal that is greater than itself.

### Business for social good

Bill Drayton, founder of Ashoka, contributed an essay to the collection edited by Alex Nicholls in 2006 on Social Entrepreneurship which identified a central issue. 'For three centuries the social and business halves of society drifted apart. So far apart that they developed different languages, styles, legal structures, and mutually negative stereotypes of one another.'<sup>4</sup> This separation goes to the heart of why business has become compartmentalised from the communities and societies whose fundamental consent and licence is essential for enterprise to operate effectively. The social contract is breaking down.

This separation is not one that can be simply bridged by corporate social responsibility, which is more a symptom of the divide than a solution.

Historically the business world has been more connected to communities and society in both direct and indirect ways. In the nineteenth century many factory owners developed 'model villages'. The idea that industrialists, entrepreneurs and business owners might build such model villages is, to many, surprising if not somewhat baffling. These villages remain today as monuments to a bygone age. However, their development reminds us that in the period of the great Quaker firms, business magnates had a real vision for

the relationship of business, family, workforce, locality and wider society.

The model villages were an expression of this integrated vision. In Bournville the houses had gardens; there was planned open space, a village green, cricket ground; and provision was made for schools, worship, shops, adult education facilities, libraries, schools, baths and so on. Both Cadbury and Rowntree decided against 'out and out sale of housing at cost price'<sup>5</sup> or anything that had the 'stamp of charity'<sup>6</sup>, preferring long leases with mortgages and deposits on a sliding scale.

There were wider housing examples in London. The Artizans', Labourers' and General Dwellings Company, a for-profit joint stock company whose President was the Christian social reformer Lord Shaftesbury, built 6,400 residences for working people by 1900, accommodating 42,000 people.

The nineteenth century also saw the beginnings of micro-finance and local banking. The Emily Loan Funds were established in memory of Lord Shaftesbury's wife, who died in 1872. They were aimed especially at flower sellers who could not operate in winter. The Fund would loan an amount to enable these women to purchase stocks of goods suitable for sale in winter or else the hire of a potato oven. Other similar 'finance societies' funded the purchase of barrows or donkeys with low-cost loans. We also see banking at work among the poor, pertinent today in our debates about credit unions

and so on. Penny Banks and Provident Societies were effectively savings banks, taking small deposits on a weekly basis.

Today this application of business skills to social problems is called 'social entrepreneurship' and 'social impact investing'. Social enterprises have become one of the new modes of business organisation for social purposes. The most effective social enterprises use a variety of means of capital, including venture capital and private equity. In addition, there will be robust governance structures, highly skilled individuals, diverse partners and a clarity of social vision. In this way it is possible to harness significant funds to achieve social purposes through the application of business skill and commercial objectives.

## The challenge of purpose

How then are we to respond to these changing features of capitalism and restore moral purpose to the heart of an enterprise economy?

Firstly, purpose needs to be restored to business. This restoration of purpose cannot be reduced to either legislative or corporate social responsibility. However, as a starting point, the repeal of section 172 of the Companies Act 2006 would signal intent. Section 172 requires directors to act for the success of the company for the benefit of members (effectively shareholder value maximisation), while having regard for employees, customers, suppliers and environmental impact. The effect is to establish a hierarchy of priorities.

However, purpose cannot simply be legislated for. Purpose and values can only be implemented in a culture, which determines the quality of entrepreneurship. So one further step is to emphasise that business success cannot be measured by a single numerical value. There may be considerable differences between the

culture of a small- or medium-sized enterprise (SMEs) and that of a large corporate entity. A small, family-run company is likely to have a very strong culture, which may be benevolent or otherwise; a large corporate may have more defined processes and perhaps a very open culture, but face significant pressures on culture from middle management in particular.

## 'The most effective social enterprises use a variety of means of capital, including venture capital and private equity'

A business culture can be defined as the attitudes, expectations and processes that shape the behaviour of a company and its employees in the conduct of business. Culture therefore includes both formal and informal aspects, personal characteristics and example, as well as good-quality processes. The key challenge is how to implement these

expectations throughout a company. Questions which might help in forming and shaping an appropriate corporate culture include:

- Does the company have clearly articulated purposes, aims and values that go beyond shareholder value maximisation?
- Is there a named person in the company responsible for purpose and aims and also the implementation of corporate values?
- What are the stated circumstances in which the company would turn down otherwise profitable business?
- Are controversial policy matters (e.g. remuneration) the subject of a clearly stated policy and process?

## The challenge of structure

The idea of the joint-stock company – that is, a company with external shareholders who share fully in the profits but are limited in their losses – has been a vehicle for raising capital for investment for over 150 years. While the structure has many advantages, its ambiguity is shown by the simple fact that prior to 1855 (the introduction

of the Limited Liability Act), the establishment of a joint-stock company required an Act of Parliament.

While the answers to the problems of capitalism do not in themselves depend on corporate structure, it can provide a framework from which other matters flow. Indeed, society is increasingly recognising the importance of corporate governance.

There are two aspects to consider. The first is formal structure. There are those, such as the B Corporation movement, who advocate formal changes to corporate structure, such as through the Memorandum and Articles of Association and an accreditation process. In *Firm Commitment* Colin Mayer advocates a 'trust company' with a 'board of trustees' responsible for the stewardship of corporate values and voting rights dependent on the length of time equity shares are held.<sup>7</sup> More detailed reflection on the relative merits of such approaches is beyond the scope of this chapter. However, in essence the more company law allows for a wider and greater variety of structures, the greater the opportunities for exploring new ways of inculcating purpose and values within a corporate structure.

The second aspect is new approaches within the current structures. The idea of the non-executive director is a powerful one, but many non-executives fail to maintain the vigorous independence the role requires. Similarly, for some the non-executive role becomes a career in itself. Thus the professions and the professional bodies should be encouraged to widen the pool of potential non-executive directors through identification, mentoring and training. Similarly, consideration could be given to restricting the number of non-executive roles that may be held by one individual simultaneously.

There is also the question of the handling of certain 'hot potato' topics. Executive remuneration is probably the most significant of these but there may also be supply-chain,

## Executive Remuneration

Graphic: The Independent



environmental or employee-related issues. In essence, clear and transparent policies are the key here, although some would argue, for example, that a company's annual remuneration report (if applicable) should be formally voted on by shareholders or the ratio of pay within the company published. These suggestions may indeed warrant adoption, but a more radical approach would be for an annual report from the independent non-executive directors covering all the key areas of risk or contention, such a report requiring to be approved at the AGM, published on the website and circulated to all employees, key customers and suppliers.

### The challenge of character

We are, in our current age of diversity and tolerance, very wary of enjoining moral codes on others. Ultimately the question is one of character. No amount of legislation, structural organisation or regulation can force good behaviour. However, society needs, for the good of business, the economy and civil society to draw a distinction between the moral and moralising. The former is a state of mind, an attitude of heart,

a recognition of responsibility and an appreciation of the impact of values on behaviour. The latter is more of the nature of 'injunctions' concerning particular behaviours. The consequences of a failure to appreciate the central importance of moral character was clearly espoused by a quote, which although unsourced, is famously attributed to Theodore Roosevelt: 'To educate a person in the mind but not in morals is to educate a menace to society.'

Among the consequences of moral character are a responsible attitude to wealth and also to society. The steely discipline that shapes an entrepreneur – the patient wait for return – is likely to enhance a view of wealth that recognises that such wealth was hard earned, is transient and carries responsibility. Equally, the apparent rugged individualism of the entrepreneur usually belies the reality of a team and a culture. Values shaped in such a setting are more likely to recognise a wider responsibility to civil society – or as was illustrated in the original corporate objectives of ICI: 'to serve ... the communities in which we are set'. Just like Cadbury at Bournville.

### Conclusions

The future of capitalism, its nature, shape and organisational features, is essential to a healthy society and indeed an inclusive economy. Capitalism carries innumerable advantages for everyone. However, all is not well. This is partly due to structural problems within the market economy but much more so because capitalism as practised today has, regrettably, rather lost its way. A breadth of purpose, responsibility towards wealth, recognition of the impact on our communities and civil society, and above all the restoration of moral character and discipline, would go a long way towards repairing the tear. We need not call this 'moral capitalism' or 'inclusive capitalism'; better just 'capitalism'. Yet the word is problematic. An 'enterprise economy' sounds so much better.

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1. William J. Bernstein, *A Splendid Exchange: How Trade Shaped the World*, Atlantic Books, 2009, p.384.
2. Milton Friedman, *Capitalism and Freedom*, University of Chicago Press, 2002, p.9.
3. See analysis by John Key, *Obliquity: Why our Goals are Best Achieved Indirectly*, Profile Books, 2011.
4. Bill Drayton, 'The Citizen Sector Transformed' in Alex Nicholls (ed.), *Social Entrepreneurship: New Models of Sustainable Social Change*, Oxford University Press, 2006, p.51.
5. P. Henslowe, *Ninety Years On: An account of the Bournville Village Trust*, 1984, p.3.
6. *One Man's Vision: The Story of the Joseph Rowntree Village Trust*, Allen & Unwin, 1954, p.4.
7. Colin Mayer, *Firm Commitment: Why the Corporation is Failing us and How to Restore Trust in it*, Oxford University Press, 2013.