Discussion of *Reimagining Capitalism*, by professor Rebecca Henderson

Jordi Gual,

Chairman of the Board, CaixaBank

Professor, IESE Business School

IESE-ECGI Conference, 30 October 2020

Good afternoon, and thanks very much to IESE and ECGI for the opportunity to participate in such a prestigious event.

I have been a faculty member of IESE for many years and a member of the Board of ECGI. Therefore, it is a pleasure to be here (digitally) and I can truly say that I am at home today. Thanks to Marco and Jordi for organizing this exciting conference.

My discussion of the presentation of Rebecca Herdenson is unlikely to do justice to her work, which encompasses not what we have just heard, but a whole book on the subject.

Be that as it may, I will give it a try. I base my comments on a summary of the book that she sent me a few weeks ago, as well as on today's presentation.

Her book starts by recognizing the huge potential of capitalism as an engine of wealth creation. I cannot but concur with such a view.

She focuses, however, on the adverse side-effects of global capitalism when unconstrained by social institutions and appropriate regulation. And she highlights how these negative social impacts are eroding the political legitimacy of free markets and asks what can be done about it by the business sector.

The harmful unintended consequences of global capitalism highlighted by Rebecca comprise environmental damages and negative impacts on social cohesion, among others. Essentially what economists would describe as negative externalities on the one hand, and skewed income distribution results on the other.

Professor Henderson makes two important, central, points.

The first is that firms have a moral duty to act in the presence of these harmful effects.

The second is that it is in their interest to do so. This idea is what sometimes is expressed as "doing well by doing good".

Let me dwell on both points.

1.- Arguing that firms have a moral duty to act is quite a strong statement. It calls for a change in the purpose of the firm, away from pure maximization of shareholder value. If internalizing externalities and reducing income inequalities are moral obligations, the whole purpose of the firm must be reformulated, embracing some sort of "stakeholderism", where the interest of all stakeholders must be considered. Moreover, those stakeholders and their interests must be important for their own sake, as ends in themselves. They cannot be instrumental, means to be used for other ends.

2.- Professor Henderson argues that even if each individual firm has an incentive not to contribute to the production of public goods or to the internalization of externalities, the overall business sector would benefit if these actions were taken by most companies. Indeed, the more advanced economies in the world (think of the Nordic countries, for example) have gradually attained such an outcome, with complex social institutions that ensure the contribution of private businesses to the common good. These institutions have been developed over a long period of time.

The solutions that Rebecca proposes try to solve two problems simultaneously: first, a collective action problem; and, second, the internalization of externalities. The measures to be adopted are a combination of government regulation that corrects market failures, with enforced cooperation (or industry self-regulation) to prevent or limit free-riding.

One could argue that this second point (the intervention to alleviate market failures and externalities), is somewhat contradictory with the first, the moral duty to act.

It is true that it ties well with the view of orthodox economists that, with appropriate regulation and enforced cooperation, the market failures can be corrected so that, despite shareholder value maximization, broader social goals can be achieved.

But it also reminds me of what is sometimes called Enlightened Shareholder Value[1]. The view that voluntarily pursuing broader business goals considering the interests of all stakeholders will, in the end, result in long term shareholder value maximization.

Whether through regulation or by voluntary choice, both approaches are clearly different from *stakeholderism*. The interests of stakeholders other than shareholders are here purely instrumental. So much so that, in the first case (regulation) they are taken into consideration only because the authorities require it.

Indeed, influential newspapers, such as the Financial Times, endorsed last year's Business Roundtable new corporate goals statement with this type of arguments. It was termed "the tragedy of the corporate commons"[2].

To try to clarify the issues at stake I like to think about this problem as follows:

---

[1] Bebchuk, L. and R. Tallarita (2020) "The Illusory Promise of Stakeholder Governance" forthcoming *Cornell Law Review*, December.

[2] Financial Times (2019) "How to build a more responsible corporate capitalism" October 13.

Imagine a world where you have two firm types.

Type 1 firms are those that maximize (long term) shareholder value subject to the restrictions imposed by the market as well as government regulation. Market restrictions, by the way, increasingly comprise not only the financial restrictions derived from capital, labor and product markets, but also the non-financial restrictions imposed by ESG indicators and the reputational pressure exerted by investors, consumers and the political system.

Type 2 firms are those that maximize (financial and non-financial) value creation for the sake of all stakeholders, balancing their often-conflicting interests and subject to the financial restriction that profitability should be above the cost of equity, at least in the medium to long term.

In such a world, the goals of shareholders and other stakeholders are totally or partially in contradiction, not only in the short term but also in the long term. Even in those instances when considering the interests of non-shareholders leads to long-term value creation for shareholders, there is always the complex issue of how to distribute the value that is created, and the extent to which financial goals override in practice non-financial concerns.

In such a world, therefore, the notion of enlightened shareholder value does not make much sense. The interests of shareholders and non-shareholders do not coincide. Even if you could "grow the pie" together[3], it will always be controversial how to distribute it among stakeholders.

In a world of **type 1 firms**, the financial objectives are dominant, and non-financial goals may be partially achieved, if regulation is appropriate and/or ESG information is widespread and actively used by consumers and the investor community.

In a world of **type 2 firms**, financial objectives are softer. The firms need not maximize shareholder value, but rather it is enough to generate at least the minimum risk-adjusted returns demanded by investors. A world populated by type 2 firms is thus a world where businesses may take on board the moral duty to care for natural resources and the overall welfare of society. This type of firms includes in their purpose explicit non-financial goals that go beyond pure profit maximization. Profit is not an end in itself for these firms, but just a means to another end, which is the real purpose of the company.

The key question is, of course, whether type 2 firms will be able to endure the competition of pure profit-driven companies which bear little or no environmental and social costs.

It is clear that type 2 firms are only viable in imperfectly competitive markets where excess rents can be generated. Leaving aside situations where rents arise due to collusive behavior or monopolistic franchises granted by authorities, the more interesting case relates to those firms that, thanks to the contribution of all stakeholders, can implement strategies that lead to a

[3]Edmans, A. (2020) *Grow the Pie*, Cambridge University Press.

sustainable competitive advantage. Such a positioning in the market provides the extra resources that ensure that the interests of all stakeholders can be taken care of.

The commitment approach pioneered by Colin Mayer[4] is an example of a stakeholder model that, for certain industries, provides a coherent framework where the incentives of the different stakeholders can coexist and work to the advancement of the broad long-term interest of the company. Grow the pie together, so to speak, even if there will always be an on-going issue of the distribution of that pie.

Another example could be the framework developed by Porter at alia[5] under the heading of "shared value". This framework, however, is even more industry-specific, since it relies heavily on the existence of technological or market opportunities that allow companies the simultaneous achievement of financial and non-financial goals.

But, if the existence of type 2 firms is at all possible, and I believe it is, the important question is also how do we get there? In practice, with the existing institutions of modern capitalist societies, how likely is it that we are going to observe a world where type 2 firms can compete and prosper?

I would argue that there are two factors that prevent the expansion of type 2 firms.

The first is the corporate law framework, which -despite the business judgement rule- in most jurisdictions is biased towards the primacy of shareholder value.

And the second is the nature of ownership that prevails in most of the corporate world, at least for large companies.

As argued forcefully by Leo Strine[6] and others, legal statutes end up constraining the leeway that directors may wish to have in terms of considering the interests of non-shareholders, especially when confronting important board decisions that may result in personal liabilities. The take-up of alternative corporate legal forms, such as the B Corporation, has been rather slow over the recent past. Similarly, in many countries corporate governance guidelines tend to be tailored to the needs and characteristics of the standard corporation, where the interest of non-shareholders is considered ancillary.

As for ownership, the standard form in most of the western world, that is, the public corporation with dispersed shareholders, promotes, in practice, shareholder primacy. The fragmentation of shareholders implies that it is very difficult to coordinate them, since they may have very different preferences. It is very hard to agree on non-financial goals, and this will often imply that managers are able to impose financial goals, since those are the indicators that are included in the incentive schemes that determine managers' behavior.

---

[4] Mayer, Colin (2015) *Firm Commitment*, Oxford University Press.
[5] Porter, M.; G. Serafeim and M. Kramer (2019), "Where ESG fails" in *Institutional Investor*. October 16.
[6] Strine, Leo (2017) "Corporate Power is Corporate Purpose I: evidence from my hometown" *Oxford Review of Economic Policy* volume 33, issue 2.

Let me finally turn to my experience at CaixaBank on these issues.

I believe that we at CaixaBank have a wise ownership structure, which allows us to support -in practice- a model which is pretty close to stakeholderism.

First, the bank is owned, 40%, by a private non-for-profit foundation. This foundation has a very long-time horizon. It is patient capital, even if it has, of course, a regular need for dividends to fund social welfare projects with an annual budget of half a billion euros.

The patient capital of the foundation provides the bank with a long-term strategic orientation, as well as with the culture and values which are behind its secular success. The financial activities of foundation started more than a 115 years ago in the city of Barcelona, and now encompass the whole Iberian Peninsula.

The long-term orientation of the bank is combined with its presence in capital markets. Equity and debt markets provide transparency and a strong quarter-on-quarter discipline, and we engage in constant dialogue with investors, to make sure that our enterprise and business models are well understood.

Sometimes the governance guidelines that have become the norm in western capital markets are somewhat rigid for our taste. They do not fully recognize the alternative enterprise model of companies such as CaixaBank, where a reference shareholder plays a stabilizing role. We live with that, although I strongly believe that it would be good if the positive aspects of having a diversity of enterprise models were to be more fully understood.

Values, culture and our long-term strategic orientation are the fundamentals of what, in practice, boils down to a stakeholder approach. As we say in our statement of purpose: we care for the financial well-being of our clients and for the progress of the communities where we operate. And, of course, people, our teams, are an essential part of this stakeholder approach. We count on them as the key contributors to the advanced services that we provide to our clients. We count on their commitment to CaixaBank, and they count on the commitment of the institution to them, both in terms of their professional development as well as their overall welfare. This mutual commitment is part of our culture and one of the sources of our sustained competitive advantage.

Finally, banking regulation and other corporate governance norms specific to the banking industry are no obstacle to our enterprise model. In fact, what they do is guaranteeing that the presence of a reference shareholder in the bank, the "la Caixa Foundation", is compatible with the interests of institutional and retail shareholders. Indeed, I would argue that the interests of all these investors is further enhanced precisely by the existence of a reference shareholder, with authority and a strong interest in a close supervision of management.