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The Future of the Company

The Global Challenge

Big business has become disconnected from the broader society within which it operates. A narrow focus on short-term returns has prevented businesses from investing in innovation to foster long-term sustainable growth.

The common understanding of the purpose of publicly listed companies, particularly in Anglo-American markets, is that they exist to maximize shareholder value. Publicly listed companies are under tremendous pressure from activist shareholders, takeover threats, and general market dynamics to generate short-term value by spinning off parts of the company, buying back shares, and laying off staff. External pressure is compounded by executive compensation schemes that are heavily weighted towards stock options. In theory, incentive compensation systems should reduce agency costs so that managers will act in the interests of shareholders. In practice, they create perverse incentives to extract value from the company at the expense of customers, employees, organizational health, the community in which the business operates, and ultimately society as a whole.

A number of unintended consequences result, including:

- The failure of companies to adequately consider and respond to societal challenges, such as environmental damage and climate change, due to the perceived cost;
- Erosion of trust between society and the corporate sector, including the role of corporations in shaping public policy, which in turn leads to a loss of trust in democratic processes; and
- Firm mismanagement through stock manipulation, insider trading and tax evasion, with a number of associated firm-level and macroeconomic risks including treating employees as disposable; undermining investment, research and development; hollowing out whole organisations; turning executives into caricatures of self-interest and greed powered by narrowly focused remuneration schemes; focusing talent in the corporate world on systematically extracting value rather than creating it; stock price manipulation; and fueling market failure and economic crash.

Inequality has greatly increased in the last twenty years, in part due to the failure to translate corporate profits into increased salaries across the firm. Even as worker productivity has continued to rise, real worker wages have essentially flat-lined. At the same time, executive compensation has markedly increased due to the afore-mentioned stock option schemes. Rising inequality within companies has in turn contributed to macro-level inequality that threatens to concentrate economic and political power in the hands of

Disconnected Business
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Listing Companies
The biggest questions we face go to the very core of business: what is the purpose of the corporation, and specifically of the large listed company with dispersed shareholders? Will the current model of large publicly listed companies survive the next decade, and if not, what will it be replaced by?

Taking a Longer View
Perhaps the most pressing issue today for financial regulators is the question of how to address short-termism in the markets and its significant influence on the strategies of public companies.

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Another question is about the alternatives to public companies, such as B-corporations, co-operatives, companies controlled by foundations, privately held companies, partnerships and family-owned businesses. Many of these alternatives have shown themselves to be capable substitutes for corporate bodies, but will they pick up momentum and drive the way forward? Will they eventually eclipse publicly listed companies? Research by the CFA Institute shows that global equity listings have declined by 17% between 1998 and the end of 2012, from 56,119 to 46,674. US stock exchanges were hardest hit, losing nearly 50% of their listings from their high of 9,253 in 1997. Europe has also seen a significant decline of 23% of its listed companies, while Asian exchanges have seen the least change with less than 5% lost. Given the sharp decline in number and longevity of public companies, it is unsurprising that many ask if a model of public limited company will survive the next decade.

Perhaps the most pressing issue today for financial regulators is the question of how to address short-termism in the markets and its significant influence on the strategies of public companies. It is widely acknowledged that an excessive focus on quarterly returns fed into the 2008 crisis but opinions vary widely on the causes of and solutions to short-termism. What is the role of financial markets and investors in promoting responsible capitalism? Can we turn institutional investors into patient capital, willing to invest in innovative research that will yield returns in the long-term? And conversely, is it possible to limit short-term trading, or at least to reduce its impact on the governance of companies?

Stewardship has become a central focus of regulators seeking to push markets to a long-term orientation. What do good stewardship and responsible investment look like in practice? Is it reasonable to expect institutional investors and corporate managers to serve as good stewards and act sustainability?

Options and Possibilities

Part of the Problem
The effects of our failure to make capitalism inclusive will become apparent: we have a generation of young people with uncertain prospects and we face rising inequality with a rising share going to the wealthy even as our wages stagnate. The corporation will be increasingly associated with these problems due to its status as the place where much of the distribution of the benefits of capitalism take place.

There is little that is guaranteed but change is certain. In the words of Lawrence Bloom, the co-founder of B.e Energy (a triple bottom line energy company), we are no longer in an age of change but in a change of age. The world faces three converging crises – economic, environmental and social – that require urgent and visionary action. Behind these crises are the failure of a worldview based on the single-minded pursuit of growth and the failure to work collaboratively to ensure that benefits are shared widely.

In the next decade, we will certainly see the effects of our failure to proactively address challenges such as inequality, the regulation of financial markets and youth unemployment. The effects of our failure to make capitalism inclusive will become apparent: we have a generation of young people with uncertain prospects and we face rising inequality with a rising share going to the wealthy even as our wages stagnate. The corporation will be increasingly associated with these problems due to its status as the place where much of the distribution of the benefits of capitalism take place.

We have already started to see the effects of climate change and business has started to sit up and take notice. How will we react and will we be able to turn the ship around? The answer to this question largely depends on the readiness of the corporate sector to

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support progressive political solutions. It is becoming patently clear that exhausting the planet's resources is not an option – a growing number of politicians and business leaders recognize we cannot burn our fossil fuel reserves without destroying the world as we know it.

Not all is grim; in the next decade we will witness the continued rise of a new generation of leaders pushing for responsible business, broader recognition of the need for gender and racial diversity in boardrooms and C-suites, and the shift of power from the global north to south and from west to east. Companies from emerging economies will certainly take on a key role in the global economy. They will bring with them different models of governance which might be more able to respond to changing conditions, although they will also introduce new challenges. Finally, the line between public and private will continue to blur. There will be mounting pressure from civil society and the general public for sustainability in business and for corporations to take responsibility for the impacts generated by their value chains and off-shore operations. The reordering of transnational legal and political frameworks will offer us the opportunity to revision the respective roles of the State, the corporation and civil society. Concerted effort is needed to nudge the process in the direction of democracy and broad-based participation.

On our current path, another crash of the financial markets is highly likely. We have not addressed the root causes of the 2008 crisis and momentum for a significant overhaul of the markets has slowed to a crawl. Will the erosion of trust in business caused by the cyclical boom-and-bust nature of markets have an impact on policy-making? It's hard to say.

The relative power of stakeholders within companies is similarly uncertain: will employees regain their voice? Will responsible investors play a more important role in influencing companies?

There are several events that could occur at the world stage that would have a profound impact on the global economy: another global energy crisis, the eclipse of Western economies by emerging economies, and the dissolution of the European Union.

The overarching uncertainties are whether we will see a rebalancing of power between different stakeholders, whether big business and key interested parties will lead or resist a rebalancing of influence, and how big a crisis is needed to jar us from our current trajectory. The risk is that entrenched interests that benefit from the current state of play will thwart reforms that threaten to limit their influence.

Responsible Business
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Proposed Way Forward

The backlash against big corporations has already fostered interest in alternative business models that will continue to gain momentum over the next decade. There is not one perfect alternative to publicly listed companies but rather a plurality of legal structures that each have certain benefits and drawbacks, including privately held companies, partnerships, benefit corporations, cooperatives, and worker-owned enterprises.

Major changes are on the way for company boards. Although problematic, the concept of stewardship has become the go-to response for regulators seeking to address short-termism in the markets, along with increasing shareholder rights. In theory, strengthening 'shareholder democracy' by giving shareholders additional powers such as a say-on-pay seems like a good way to encourage institutional investors like pensions and sovereign funds to steer companies in the right direction. In practice, however, it is unclear whether we can expect investors to take on this responsibility.

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Board Diversity
It may be that other stakeholders besides shareholders will take on an increasingly important role. Board level employee representation is well established in much of continental Europe and has started to receive some attention at the EU level. Board diversity is also a key topic now and will almost certainly be into the future. We may see reserved seats for women, visible minorities, and other traditionally under-represented groups.

Integrated Reporting
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Thoughtful Policymaking
Thoughtful policymaking is needed; indeed, perhaps the best we can do is to try to 'nudge' behaviour in the right direction and closely monitor the results, ever ready to react to changes.

A slight variation on this would be to assign different powers to different classes of shares.

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The classic maxim says that what is measured is what matters. The traditional focus of firms on measuring and reporting on almost exclusively financial indicators is changing to look at a broader set of indicators. In the EU, the recently adopted Non-Financial Reporting Directive requires certain large European companies to disclose information about environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters. Integrated Reporting (<IR>) was devised less than a decade ago but has been picked up by an increasing number of companies who welcome the ability to tell a story about the whole picture of the company, which is often overlooked in quarterly reports. Closely related is the question of how to share information about companies to potential investors and the public. There are several ideas out there for developing benchmarks and labeling standards to identify sustainable companies and financial products, similar to what has been done for Fair Trade products.

There are two main ways to influence behaviour: sticks and carrots. Ideally, we will push companies to be pro-social through a combination of both regulatory policy and economic incentives. For example, there has been a lot of discussion in the context of climate change about introducing taxation of externalities, e.g. carbon taxes, as well as a carbon market. The EU has also considered proposals to impose a transaction tax on financial markets to reduce volatility and generate revenue, which has been used in other jurisdictions with inconclusive results. We may see requirements imposed to devote a certain percentage of revenue to CSR, as is being implemented in parts of Asia.

The Benefit Corporation and similar models might be supported by governments, either by tax incentives or by preferential treatment in public procurement. Farsighted States may reform their company law to introduce mandatory elements of corporate purpose, such as, for example, the concept of making decisions with an aim to remaining within our planetary boundaries, and adjusting directors' duties and responsibilities accordingly. These changes have the potential to have high impact because they could shift economic activity to a new model – and for that reason, they are unlikely to be implemented. Other debated regulatory reforms include caps on executive pay and/or pegging executive pay to non-financial returns; changing the rules on the legal liability of multinational enterprises to allow parent companies to be held legally liable for the actions of their foreign subsidiaries; and restrictions on firms' right to buy back their shares. Each of these reforms is potentially important but it is only when they are taken together that they have a chance to lead to system-wide changes to business conduct.

In terms of incentives, almost any of the regulatory reforms discussed in the previous paragraph could be framed instead as an incentive with a bit of ingenuity. Additional ideas include introducing incentives for boards to change their composition or to balance the short-term financial interests of the company with long-term and/or non-financial interests. Thoughtful policymaking is needed; indeed, perhaps the best we can do is to try to 'nudge' behaviour in the right direction and closely monitor the results, ever ready to react to changes.

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Impact and Implications

Tailored solutions will be needed to respond to the unique characteristics of each region. For example, the continental European, Chinese, Japanese and Anglo-American economics and business models are each very different. Germany is characterized by a small number (less than 700) publicly listed companies with worker representation on company boards, whereas mandatory board-level employee representation would be a controversial proposition in the UK or the US. The EU will be forced to confront and reconcile these types of discrepancies in the corporate governance models of its Member States as it asserts an increasingly active role in company law, which has traditionally been under the purview of national governments.

Outside of the EU, we need to bring Asia, the Middle East and Africa into the discussion of sustainability, workers' rights and human rights more generally. This will require thoughtful balancing of the local context with international standards. In the context of human rights, the UN Guiding Principles on Business and Human Rights outline the responsibilities of States to enforce the principles of international human rights law and of companies to respect those principles. But more work is needed to translate the framework into context- and industry-specific guidelines. It is in the implementation of general principles and the reconciliation of potentially contradictory rights that compromises will be most needed.

If this process is successful, we may see a gradual reduction in inequality leading to less social unrest and less partisan politics. We may also see an increasingly prominent role for business in developing both soft and hard law in a transparent way, acting individually and in concert through more progressive collaborative initiatives than the current trade and industry associations that dominate policy circles in Brussels, Washington and London.

We need a new vision for the role of business in society. Part of the reason why the focus on maximizing shareholder value and short-term profits has captured business for so long is due to the failure to create consensus around an alternative conception of the purpose of the corporation. A model of corporate governance narrowly focused on maximizing shareholder value in the short-term is unbalanced and self-destructive. The paradigm that will rise to replace the current one will need to have a more holistic understanding of profit as one indicator of the long-term health of the organization, amongst others. The profit-making motive will sit comfortably alongside a consideration of a broader responsibility to the interests of society.

This new paradigm must be translated into the existing framework of incentives and regulations for corporate governance and accountability. It needs to be reflected in market mechanisms, in particular in the way that financial markets interact and influence companies. The role of shareholders in corporate governance will have to be rethought in order to protect their role in ensuring management accountability, whilst freeing companies from the imperative to maximise the stock price as at all costs.

In order to achieve transparency and accountability, companies will need to provide an accurate accounting of their environmental and social impacts, through required disclosure and through increased pressure for meaningful information from consumers. Boards of directors will also need to revise their decision-making process to consider the effect of the company on the environment and society. Companies should be expected, encouraged and even required to develop long-term plans charting their way towards environmental and economic sustainability. It will be necessary to devise holistic measures for measuring corporate success in the long-term, reflecting their ability to create value in a responsible manner. These metrics should be reflected in incentives for corporate executives as well as for institutional investors. We need to consider whether the current level of public investment in research and development is sufficient and properly allocated to achieve transformative change. Public-private partnerships, while not without flaws, are one path to support and stimulate green growth.

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Measuring Success
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Acknowledging the Problem
At some point, we will be forced to acknowledge that the current approach to governing companies is broken. Perhaps after the next financial crisis, but hopefully sooner. Certainly as we are forced to respond to climate change, which cannot be addressed by governments alone without the support and investment of business.

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Lead Expert – Paige Morrow

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About Future Agenda

Context – Why Foresight?

In an increasingly interconnected, complex and uncertain world, many organisations are looking for a better understanding of how the future may unfold. To do this successfully, many companies, institutions and governments are working to improve their use of strategic foresight in order to anticipate emerging issues and prepare for new opportunities.

Experience shows that change often occurs at the intersection of different disciplines, industries or challenges. This means that views of the future that focus on one sector alone have limited relevance in today's world. In order to have real value, foresight needs to bring together multiple informed and credible views of emerging change to form a coherent picture of the world ahead. The Future Agenda programme aims to do this by providing a global platform for collective thought and innovation discussions.

Get Involved

To discuss the future agenda programme and potential participation please contact:

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Future Agenda 1.0

The Future Agenda is the world's largest open foresight initiative. It was created in 2009 to bring together views on the future from many leading organizations. Building on expert perspectives that addressed everything from the future of health to the future of money, over 1500 organizations debated the big issues and emerging challenges for the next decade. Sponsored globally by Vodafone Group, this groundbreaking programme looked out ten years to the world in 2020 and connected CEOs and mayors with academics and students across 25 countries. Additional online interaction connected over 50,000 people from more than 145 countries who added their views to the mix. All output from these discussions was shared via the futureagenda.org website.

Future Agenda 2.0

The success of the first Future Agenda Programme stimulated several organizations to ask that it should be repeated. Therefore this second programme is running throughout 2015 looking at key changes in the world by 2025. Following a similar approach to the first project, Future Agenda 2.0 builds on the initial success and adds extra features, such as providing more workshops in more countries to gain an even wider input and enable regional differences to be explored. There is also a specific focus on the next generation including collaborating with educational organizations to engage future leaders. There is a more refined use of social networks to share insights and earlier link-ups with global media organizations to ensure wider engagement on the pivotal topics. In addition, rather than having a single global sponsor, this time multiple hosts are owning specific topics wither globally or in their regions of interest. Run as a not for profit project, Future Agenda 2.0 is a major collaboration involving many leading, forward-thinking organisations around the world.