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Why corporations inhibit social progress

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Why Corporations Inhibit Social Progress. A Brief Review of Corporations from Chapter 6 'Markets, Finance and Corporations. Does Capitalism have a Future?[1]

A *deficit of social progress is directly attributable to the corporation and its ability to operationalise inequality and to inhibit innovation. In 'Markets, Finance and Corporations. Does Capitalism have a Future?' we set out how and why the corporation creates barriers to social progress by perpetuating inequality and exploitation and in directing innovation to increase profit rather than meet the needs of society.*

Inequality is coincident with different groups' relationship to corporations

What is most striking about inequality in the 21st century is its coincidence with particular groups' relationship with corporations. Those whose income mainly derives from corporate revenues make up most of the top 0.1% of American society. The bottom 90% rely on wages as their main source of income.[2] Of the wealthiest 0.1%, most are shareholders, some in private companies, and controlling shareholders of the large corporations make up most the top 100 billionaires listed by Forbes.[3] In addition to shareholders, an increasingly large percentage of this top 0.1% are corporate managers whose income is connected to the performance of shares. Class, in its nineteenth century formulation, as determined by one's relationship to the 'means of production', remains true today. Class defines modern society. Indeed, statistics on inequality in the United States show that inequality in 2012 is at a higher level that in 1918, an historical period noted for such profound class and gender inequalities that it precipitated radical demands for change, from gender equality to revolution.

[1] This article includes edited extracts from Chapter 6

[2] Economic Policy Institute 'CEO Pay remains high relative to the pay of typical workers and high-wage earners' https://www.epi.org/files/pdf/130354.pdf

[3] Forbes https://www.forbes.com/billionaires/#55dd231f251c

Corporate managers joined the wealthiest 0.1% class who derive most of their income from corporate revenues, since the 1980s. This arose as a direct result of the ideologically driven agency theory which reframed long-standing concerns with director accountability in the context of dispersed, powerless, passive shareholders, as a problem of misalignment in the 'contract' between shareholder/principal and director/agent.[4] By binding directors' reward to the achievement of shareholder value, their mutual interest would align. This could be achieved by paying directors with share-based rewards, or aligning pay to performance where performance was narrowly defined as raising share value. In the UK this approach was institutionalised in the corporate governance Codes, specifically Greenbury (1995) – and bar some finessing with longer term incentives instead of share options - performance related pay has remained the defining feature of executive pay in the UK, and in the US. Performance related pay has remained in place despite public dismay at executives' exorbitant rewards, which have continued to rise in the post GFC period in line with share prices. In 2017 alone, executive pay rose 11% in spite of initiatives to moderate pay such as more board diversity. It is worth noting that in England and Wales, when director pay was set by the board itself, (allowed by the model articles from 1902), pay was little more than professional wages.[5] In 1965, executive pay was 20 times that of the average worker in that corporation. In 2018, it is 350 times average pay.

In '*Does Capitalism have a Future?'* we argue that the agency problem is a flawed construct. However, if there is an agency problem, it is that there is *not* one and if corporations are to be governed inclusively to promote social progress there *should* be an agency problem. In other words, if directors have intrinsically different interests than shareholder value this is not a problem from a social progress perspective. Indeed, if directors are to govern inclusively they necessarily cannot pursue the best interests of shareholders at all times. Director self-interest therefore should be unbound from the interests of this one group. At the very minimum directors should govern as objective arbiters of the best interests of the corporation as a productive entity.

[4] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p232
[5] The norm today being pay set by a subcommittee of independent directors.

Governing for shareholders is a barrier to social progress

The neoliberal argument that when corporations, through their directors, pursue shareholder value they are more efficient, as this removes exogenous interferences with the market is simply wrong – unless we think that efficiency is simply achieving shareholder value, so pursuing shareholder value must necessarily be efficient.

However, if we think that efficiency means investing in productivity and innovation which improves people's lives, then shareholder value is a barrier to this. The directing of profit to shareholders and CEO performance pay 'does not reflect correspondingly higher output or better firm performance'.[6] Instead, it means that income and profit streams are not available for reinvestment, or for the wages of other employees. This negatively impacts people's lives because their wages and standard of living falls or stagnates; 'Real wages are due to be flat next year, and even in 2022–23 average earnings are due to be below where they were in 2007–08. That implies a lost decade and a half of wage growth, an unprecedented period of stagnant earnings in the UK.'[7]As Mishel states, "As a mathematical matter, had there not been the redistribution upward … the wages of the bottom 90% could have grown twice as fast as it actually did."[8]

Social progress, inequality and the Nation State

That this level of inequality exists is in large part explicable by the political orientation and actions of the state. Corporations are grounded within, and dependent upon the state. At a fundamental level, the state protects private property and market exchange. It secures the conditions for the operation of labour markets, shaping the exchange of values between capital and labour, through the legal construction of the employment contract, and ensuring the subordination of labour to capital, which is essential to a capitalist economy.[9] Corporations are dependent

[6] Economic Policy Institute 'CEO Pay remains high relative to the pay of typical workers and high-wage earners' https://www.epi.org/files/pdf/130354.pdf
[7] T. Pope 'It may just sound like a statistic, but productivity growth matters for all of us' https://www.ifs.org.uk/publications/10191 Huffington Post 24 November 2017
[8] https://www.theguardian.com/business/2018/aug/16/ceo-versus-worker-wage-american-companies-pay-gap-study-2018
[9] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p224

upon the nation state for the defence of their increasingly intangible property interests under globalisation. For at least the last three decades, the common business model for corporations located in the global north is to retain and develop their core competencies while outsourcing other parts of the productive process to countries with cheap labour, largely located in the Global South.[10] Production, trade and consumption are increasingly contained within these global value chains. The outsourced part of production is subject to competition, and the greater the competition, the lower the costs and the greater the share of the value chain that corporations can capture.[11] For outsourced workers, competition translates to lower wages, less job security and an unsafe working environment. In contrast, corporations' ability to retain exclusive rights to the 'core', the greater value of the chain (technology, branding, market position) is a monopoly right, protected by the state, frequently through intellectual property rights.

In 'Does Capitalism have a Future?' we show how globalisation has had significant implications for social progress. Because states see themselves as competing with one another for investments and corporate relocations there a shift away from the publicly instituted regulation of the post war decades, in favour of forms of 'governance' suitable for more liberalized and less welfare-orientated economies – a global race to the bottom. International agencies which previously operated to contain the destabilising effects of cross-border flows of goods and resources, now actively promote the removal of social and environmental protections which are described as 'non-tariff barriers' to trade. Increasingly the corporate sector regulates itself, imposing standards and which governs access to niche markets. Corporations have a huge capacity to influence regulation in their interests and to sideline social progress issues such as environmental protection and labour issues.[12]

The advance of globalisation through the medium of global value chains (GVCs) has greatly benefitted global investors in lead corporations. It has allowed major corporations to sustain their growth by escaping the limitations of their domestic markets by providing them with access to new technologies and new inputs. Larger

[10] UNCTAD, *World Investment Report 2013: Global Value Chains and Development: Investment and Trade for Development*
[11] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p230
[12] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p229

markets have provided the opportunity for lead firms to gain from economies of scale and to specialise in their core competences. This in turn has created barriers to entry and provided scope for rent generation and appropriation. The spread of GVCs has provided a much enlarged and much cheaper global labour force for global firms to draw on, with production relocated to low-wage environments in Asia, Central America, North Africa and elsewhere, creating the largest ever proletariat. There are mixed views on whether this constitutes progress for those countries. In China, low wage, unskilled tasks in outsourced work is increasingly displaced by higher skilled work in technology-intensive intermediates and final products. However, in the garment industries in Bangladesh, work remains low skilled, poorly paid and often dangerous. Outsourcing has certainly caused wage erosion in the high-income economies, with the attendant right wing populism of rustbelt regions. The rise of GVCs and transnational corporations has undermined the tax base for individual nation states, as corporations are increasingly able to claim high profit making parts of the value chain are located in low tax regimes. States struggle to tax transnational corporations effectively, impacting the global distribution of wealth as developing countries are often the least able to effectively claim corporate tax. Finally, globalisation has led to adverse environmental impacts that are over and above those that would have emerged through more locally focused forms of capitalist development. By their nature, GVCs which outsource their supply chains across the globe make demands on energy intensive and polluting logistical systems, with massive environmental externalities.[13]

An economy for the few enabled by the corporation's legal architecture

It could be reasonably argued that the privileging of capital at the expense of labour is just the routine operation of capitalism, and that globalisation is simply a continuation of that process. The organisational and legal form adopted by capitalist firms is largely irrelevant as they successfully operate as non-corporate as well as corporate forms. However, we argue that there is a difference worth analysing. The corporation's legal architecture more readily lends itself to the allocation of wealth to capital/shareholders (and those aligned with capital) rather than the productive entity, labour or the community.

[13] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p230

First, corporate law constructs the corporation as a distinct legal entity from whose liabilities shareholders are shielded. However, while separate corporate personality is protected in the most extreme examples of corporate abuse in corporate groups, it does not extend to conceptualising the corporation as independent from the demands of specific interest groups. Corporate law, with different degrees of specificity according to jurisdiction, requires directors to promote the corporate interest, which is generally interpreted as maximising shareholder value. Simultaneously, that same interest group is protected from corporate liabilities for social or environmental externalities. Under English company law, promoting the corporation's interest is a director's statutory duty to 'promote success of the company for the benefit of the members'. Shareholders have legal powers to ensure directors adhere to that duty including removing them by a majority vote, or by voting against a proposed remuneration policy, thereby rendering the corporation unable to pay its directors.[14] Shareholders are conceptualised as outsiders in respect of corporate liabilities, but insiders in terms corporate governance orientation and control rights in the corporation.

The pressure to promote shareholder value has also led to a dramatic rise in share repurchases or 'buybacks'. In Between 1997 and 2007, buybacks accounted for almost one third of distributions to shareholders.[15] From 2017-18 UK companies repurchased £15bn of their own shares. Shell PLC alone has recently announced its intention to buy £17.7bn of its own shares over the next ten years.[16] In contrast, traditional mechanism for producing shareholder value, such as raising productivity and investing in innovations to make profits from the sale of products are not guaranteed to create shareholder value and take time to come to fruition. Many innovations involve costly investments in research and development (R&D) and are a long time in the making. Their returns may also accrue over long periods, particularly in the case of technologically complex or risky innovations. Hence, many corporations will tend to steer away from these types of innovations, and prefer to invest in innovations that are more trivial with a shorter payback period. This will have a cost to society at large, but also to the long-run profitability of the

[14] In order, The Companies Act 2006 s.172, s.168 and s.439(A)

[15] L. Renneboog and G. Trojanowski, 'Patterns in payout policy and payout channel choice' (2011) 35 *Journal of Banking and Finance* 1477-1490.

[16] https://www.telegraph.co.uk/investing/shares/share-buybacks-soar-can-spell-bad-news/

corporation.[17] Driven by shareholder value, management is reluctant to allocate funds into R&D. According to the Institute of Fiscal Studies, low rates of productivity can be directly attributed to the actions of corporations in reducing investment. The ONS report of November 2018 showed that 'Business investment has weakened in recent periods, with growth slowing for the fifth consecutive quarter'[18]

The drive for assured, fast and high returns on investment means that innovation by corporations is driven and shaped by concerns which perpetuate inequality.

> Innovation responds to purchasing power, and since the overwhelming share of global demand has emanated from high income consumers, innovation has resulted in products that predominantly meet the needs of the wealthy. An economic system driven by profit, amplified by the corporate drive for shareholder value, will invest in innovations with the largest potential for profit, that is to say, those focused on the wealthy, even if there are, in principle, profitable innovations available which would help the less well-off, thereby reducing inequality.[19]

As 'Does Capitalism have a Future?' shows, in the pharmaceutical industries innovation has targeted the needs of higher income consumers such as treatments for dementia and cancer, or to chronic conditions requiring life-time medication, rather than on neglected diseases such as malaria which affect the lives of hundreds of millions of people.[20] Moreover, since capitalist innovation involves the private appropriation of rewards, this has favoured the development of curative pharmaceutical formulations protected by intellectual property rights, rather than preventive public goods such as immunization whose benefits are difficult to capture by innovating firms.

The pressure to produce shareholder value, the risk of investment, and falling returns on investment and low interest rates, have led many corporations to fund R&D through debt. US corporate debt levels are 30% higher than before the global

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[17] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' P229

[18] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/julytoseptember2018

[19] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p228

[20] Chapter 6 'Markets, Finance and Corporations: Does Capitalism have a Future?' p247

financial crisis and the $8.6 trillion of corporate debt constitutes 45.3% of GDP.[21] However, for all but the so called 'superstar corporations', debt becomes a huge burden and corporations become embroiled in debt servicing and debt is no longer utilised for productivity investment. The Bank of International Settlements highlights the growth in these 'zombie companies', those just about able to service their debts but with no ability to invest and progress.

Super exploitation as an answer to low innovation

In recent years, both the UK and US have boasted of their historically low unemployment levels. However, this is not an indicator of economic strength. Corporations offset their lack of investment in innovation and productivity by the use of low paid precarious domestic labour. There are huge rises in those in work but living in poverty, as wages have stagnated or fallen. Globally, there has been a rise in 'super exploited' labour[22] and forced labour in GVCs. The scale of the latter practice is hard to estimate, given the difficulty in obtaining data about the extent of offshoring by UK corporations. One initiative to enhance data is that the UK Modern Slavery Act 2015 imposes a 'Transparency in Supply Chains' obligation. From 2016, UK corporations with a global turnover of over £36 million have been required to make an annual statement regarding their monitoring of supply chains to prevent the use of slave labour. However, this requirement has generated little more than general statements on the abhorrence of slavery, while slavery itself continues.[23] The ILO estimates that $150billion globally is generated from forced labour in value chains.[24] The amount generated from acute low pay and poor working conditions in global value chains is, of course, much greater, with global value chains making up 80% of global trade.[25]

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[21] M. Roberts, 'The End of QE', 21st September 2017, https://thenextrecession.wordpress.com/2017/09/21/the-end-of-qe/
[22] J Smith *Imperialism in the 21st Century* (Monthly Review Press 2017)
[23] See for example UK Parliament, *Human Rights and Business 2017,* paras 92-105
[24] ILO, *Combating forced labour: A handbook for employers and business*, (revised edition 2015)
2015 Combating Forced labour: handbook for Employers and Business.
[25] UNCTAD, *World Investment Report 2013: Global Value Chains and Development: Investment and Trade for Development* at 135

Shareholder value driven corporate activity has a negative impact on research, innovation and productivity. This is a failure of capitalism even on its own terms. Profit seeking was justified in Schumpeterian analysis as driving innovation and forcing out old technologies through 'creative destruction'.[26] However, today, profit seeking is more likely to be pursued by avoiding innovation and capital investment and by maintaining old technologies because low labour productivity can be offset by low domestic wages and super-exploited labour in global value chains. Directors are cautious about undertaking long-term investment because shareholders avoid corporations with long-term investment plans. Committed investment in R&D is considered too risky.[27]

Conclusion: Corporations and Capitalism

The legal architecture of the corporation law makes all this seem acceptable because it drains the relationship between capital and labour of political content. Corporate law reified the share as a title to revenue, and made shareholder entitlement an incontestable and natural attribute of share ownership; crucially obfuscating the true exploitative relationship between capital and labour. The legal architecture of the corporation facilitates the distribution of corporate wealth to capital and away from labour. In a period of low profitability, it also moves capital away from investment and innovation.

The proposals that we present are designed to rebalance power in the corporation away from the executive/shareholder alliance and toward employees and the community. They start a process that we look forward to continuing, redirecting the corporation toward social progress rather than shareholder value. The policy goals of future reforms should aim to reduce the power of executives and shareholders and enhance those of employees and the community. Currently, shareholders' control rights in the corporation are extensive, and the trajectory of the post global financial crisis GFC reforms in corporate law and governance have aimed to enhance those

[26] Schumpeter, J. *Can Capitalism Survive?* (First edition Harper and Row, 1947. Martino Publishing 2011) p23

[27] Talbot, LE 'Trying to Change the World with Company Law? Some Problems' (2016) 36 *Legal Studies* 513 at 520

rights. The power of the executive/shareholder alliance is supplemented by the unelected, unaccountable, supranational shareholder organisations, which provide guidance, advice and information to national governments on soft law governance. This set of arrangements can only enhance inequality and set back social progress. The corporate form shields shareholders from liabilities, which are borne by others, while enabling the hollowing out of its productive capacity to meet shareholder and executive demands to the detriment of labour, the community and to the future. It is unsustainable and requires radical intervention.