DISCUSSION DRAFT

The Purpose and Responsibilities of the Public Company

Statement of Aims

Introduction

Corporate Governance could not be more topical. The continuing debate about short-termism; concerns about the lack of shareholder control over incompetent or self-serving managements; pressures to harmonise European Company law; prospects of a Hanson bid for ICI: all have kept the pot boiling. Yet the debate has focused on means not ends. The objectives and values which the company should serve, the assumptions which lie behind the debate, have not been examined.

This paper sets out the case for the RSA to organise an enquiry into these objectives and assumptions, in other words the purpose and responsibilities of the public company. Included are the background to, and scope of, the proposed enquiry, the outputs of the work and the suggested approach.

Background

In his Michael Shanks Memorial Lecture to the RSA in December last year, Professor Charles Handy argued for a radical re-think of the attitudes and behaviours relating to the limited liability company. The idea that companies exist solely to maximise earnings per share is a fiction, he argued. Profit is a means, not an end, the end being to do and make things, to grow and develop. The notion that shareholders are true owners is also a myth, said Professor Handy. Investors are more like punters at a racecourse, transferring their money from one nag to another, depending on who seems to have the best prospects.

Instead of regarding companies as properties to be bought and sold, we should recognise them in law as communities of managers and workers, accountable to trustees representing long term interests and concerns. Maintaining and increasing profits is a necessary, but not sufficient, objective. Obligations to customers, employees and society at large should be made explicit. Shareholders should become "mortgage men", able to exercise control only if the company defaults on the dividend.

The leading industrialists and businessmen who attended a seminar at the RSA in March to discuss these ideas were generally not prepared to be as radical as Charles Handy. Nevertheless they were concerned that the competitiveness of UK enterprise is being undermined by a preoccupation with short-term objectives. They felt that necessary investments in research and development, training and education, design and other intangible assets are not being made because of the focus on short-term earnings. Responsibilities to stakeholders other than shareholders are neglected. With small shareholders unable, and institutional shareholders unwilling, to exercise supervision over management boards, executive directors are not held to account except by the negative power of shareholders to sell to a hostile bidder.

But what remedies are proposed to these problems? In recent months different groups have advocated greater corporate disclosure, strengthened non-executive directors, employee share ownership, supervisory boards, more owner capitalists, turning the investment institutions into active owners. What has been missing has been the opportunity to develop the argument beyond a "dialogue of the deaf": viewpoints and interests being stated without a serious effort to understand and deal with points made by other groups.

More fundamentally, the assumptions on which analyses and suggested remedies are based have not been re-examined. What are companies for? Whom do they exist to serve? What responsibilities do they have to groups other than shareholders? Is it right that the future of a great industrial enterprise can be decided by shareholders alone, regardless of the wishes of management, workers and customers? In an age when skills, not capital, appear to be the scarce resource, can the dominant position of shareholders continue to be taken for granted?

As the Financial Times put it in an editorial of 20 June, recent enquiries, by accepting current assumptions, are in danger of "patching up the existing system rather than pointing the way forward to a new approach".

In this effort the RSA has a valuable role. With its freedom of vested interest and its ability to bring people together across the "frontiers" of British life, the RSA can provide a forum for the dispassionate examination, and hopefully resolution, of fundamental issues.

Scope of Enquiry

The suggested terms of reference for the enquiry are:

"To examine the purpose and responsibilities of the public company in the UK and to consider whether changes are needed to bring them into line with modern social and economic circumstances and to enhance the prospects for long term wealth creation.

The enquiry will consider:

1 Whether creating value for shareholders should be the sole, or even the main, purpose of the company? What other objectives should be recognised?

2 How should the responsibilities of the public company be defined? How should the needs and interests of stakeholders, other than shareholders, be recognised?

3 How would any changes in purpose and responsibilities contribute to long term wealth creation? (1)

4 How should companies measure how far they are achieving their purpose and discharging their responsibilities?

5 What processes and resources should companies put in place to achieve their purpose and responsibilities?

6 What distribution of power is compatible with the stated purpose and responsibilities?"

In examining these questions, the enquiry will want to keep in mind the European and other international context - in particular the movement to harmonise European Company Law and the globalization of markets.

Once it has reached a view on these issues, the enquiry may decide to go on to a second stage of examining what changes to corporate governance are needed to give effect to its recommendations on purpose and responsibilities. It would only be at this potential second stage, and after coming to a decision on purpose and responsibilities, that the enquiry study the mechanisms of corporate governance and thus begin to overlap with other current enquiries into the subject.

Outputs

The objective is to contribute to a change in attitudes and thus in the behaviour of investors, managers and workers. To this end the enquiry should produce:

1 A conclusion as to whether a new view of the purpose and responsibilities would contribute to long term wealth creation.

2 If the answer to 1. is yes, clear alternative model(s) of the purpose and responsibilities of the public company.

3 Recommendations on the measures and processes to be used, and redistribution of power needed, to realise proposed purposes and responsibilities.

4 Suggested supporting changes in law, regulation, leadership and attitudes.

Approach

It is suggested that the Target Team approach (borrowed from Business in the Community) is adopted. This would involve drawing together respected figures from industry, the City, the academic world and the Law, who will give credibility to the team's conclusions and have the ear of decision makers in politics, the Civil Service and elsewhere. Such people may also be able to draw on experience of reform within their own organisations and to help with the funding of the project.

The Target Team should include a mix of figures currently in top jobs and others with good prospects of reaching the top, who will be able to carry the initiative forward in future years, if it takes root in the way it is hoped.

The team would need high quality staff support with expertise in management, finance, the law and politics. This group would ensure that the time of the senior people was used to best effect, that issues were clearly identified and that decisions of the team were implemented.

Given the complexity and also the conceptual nature of the subject of the enquiry, the team will wish to canvass opinions and seek expert advice from as wide a range of contributors as possible.

Conclusion

The intellectual framework which governs the public company has altered little in more than 130 years, despite enormous social and economic change. The task of changing the framework is an enormous and far reaching one and it may well be argued that it is too much for any one institution. Yet someone must initiate the work. Without a clear conclusion on principles and values the current work on the means of corporate governance will be uncertain and indecisive and will not achieve the objectives its proponents hope for.

Note:

(1) The test of contribution to long term wealth creation is one suggested by the Manufactures and Commerce Committee of the RSA and is linked to the RSA's theme of "Sustainable Worlds".

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2 July 1991

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Operating Plan

The following outline plan should be read in conjunction with the draft statement of aims for this project. A much more specific plan will be needed as and when that statement is agreed.

Plan Steps	Month
1 Agree statement of aims	1 to 2
2 Secure funding for start-up period	1 to 2
3 Recruit Target Team chairman	1 to 3
4 Recruit Team members, sounding out potential candidates at a number of lunches or dinners and secure the financial contribution of those who join	3 to 6
5 Recruit staff support group	1 to 6
6 Agree work programme with support group and Target Team	6 to 7
7 Hold small workshops involving the Team and relevant experts on priority topics	6 to 16
8 Set up sub-groups to resolve specific issues, perhaps arising from the workshops	6 to 16
9 Discuss draft findings at open meetings of RSA fellows	12 and 18
10 Prepare and agree report; decide whether to proceed to second stage on how to modify corporate governance to help implement any agreed proposals on purpose and responsibilities	18

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