REIMAGINING THE CORPORATION: WHY WE NEED TO CHANGE THE PURPOSE OF OUR BIGGEST COMPANIES

INTRODUCTION

I am going to begin and end this speech in the same place.

And that is that the fundamental purpose of our marketplace economy is about the welfare of the community.

It isn't to maximise the pay packets of CEOs. It isn't to maximise shareholder value. And it isn't to maximise the welfare of workers or consumers.

It's to maximise the welfare of all of us.

In particular, I want to talk about how we've mischaracterised the purpose of companies as being solely about profits. Profits before people as Commissioner Hayne put it.

So how did we get here and how do we fix it?

HOW DID WE GET HERE?

Our major consumer markets are all oligopolies

The great trend of post-war capitalism is what has been described as the "great merger movement". Let's look at the situation in Australia.

- In banking, there are just four major banks. They have an 80% share of the mortgage market.
- There are three big utility companies.
- Two supermarket chains.
- Two airlines.
- There are four large general insurance companies – although you wouldn't know that because they sell their products using multiple brands.
- Our mobile phones are provided by three main providers[1] and the NBN by four.

[1] "Competition for mobile services is concentrated in the hands of the three mobile network operators (MNOs) that account for 91 per cent of mobile services." ACCC Communications Sector Market Study, April 2018, p

- There are five major providers of health insurance, and two of those have a combined 50% market share.

- In the digital world, two companies - Google and Facebook - filter our news and mine our data.

I think you get the picture. All of our major consumer markets are oligopolies.

This structure isn't delivering for the community

There isn't anything fundamentally wrong with any form of market structure - as long as it meets the test I set at the outset of maximising the welfare of the community.

But these businesses are not doing that.

Here's a few random examples (and I could have given a hundred):

- Optus knew from 2014 that customers were being billed for ringtones and games they didn't want. But they earned commissions from those sales, so they did nothing about it.

- In electricity, we're faced with a blizzard of advertising, misleading discounts and price gouging. And there's more people on financial hardship programs than ever before.

- And in case you didn't notice it, we've just had a Royal Commission into misconduct in the financial services sector.

In my view, the system is not only broken, its becoming more so.

I think the problem at its heart is one of both culture and structure.

But before I explain what the solution could be, I want to make a few observations about what is happening.

UNDERSTANDING THE PROBLEM

First, it is worth noting that much of this poor – sometimes shocking - behaviour doesn't actually break the law.

It isn't illegal to charge financial advice commissions long after they were supposed to stop. And it isn't illegal to take a "go slow" or shoddy approach to remediation programs.

Second, new laws can help, but we'll always play catch up. Product intervention powers, laws to encourage more competition or an unfair behaviour law – they're all good but they'll never be enough.

All behaviour is legal unless there is a law prohibiting it. This will always make protecting the environment and the public interest a difficult task.

Third, we're now dealing with really big and very, very powerful organisations. Their lobbying power is extensive. And they use it to water down or block good laws.

And fourth, an important reason all of this is happening, is that competition as a force for good isn't really working.

These businesses are operating in consumer markets that are complex, confusing, concentrated and compulsory – you can't opt out of banking, electricity or the internet.

What we get is the illusion of competition – lots of confusing electricity offers, opaque mortgage prices, and unsuitable products.

WHY THIS MATTERS

It is worth pausing here for just a moment because this is really important stuff.

I'm painting a pretty bleak picture. But we've become so used to companies behaving badly that we just seem to accept it as the cost of doing business.

It shouldn't be like this.

The inability of our big corporations to act in the community interest is one of the reasons – not the only reason – but one of the reasons – so many people are losing trust in business and capitalism. And this translates into populism and a loss of faith in our democracy.

Fixing it really matters.

WHAT'S THE CAUSE?

But we can't fix this problem unless we understand the cause.

<u>In my mind, this is that under our current system of corporate governance, the interests of shareholders are inevitably prioritised over the interests of anyone else.</u>

As I said earlier, it is both a cultural problem and a structural problem.

To understand what I mean, let's talk about something completely different for a moment: tennis. Imagine that you and a few other people are members of the local tennis club.

You don't own the tennis club – it's a separate legal entity. But you get to vote each year for the new board members. If the tennis club makes a profit, the funds are ploughed back into say new courts, or lower membership fees.

Now let's say that the tennis club lists on the stock exchange. You still don't own the tennis club – it's a separate legal entity. What you own is shares – you have a right to vote for who is on the board and depending on what the directors decide, you might get a share of the profits.

Cultural problem

So here's the cultural problem – we keep talking about shareholders as if they own the company. They don't. Being a shareholder is a contractual right. The company owns itself.

This is going to challenge a lot of people, because the idea of "shareholders as collective owners" is indelibly ingrained in corporate culture.

It is one reason that the people running companies find it hard to consider the interests of other stakeholders.

There is no doubt that if we were freed from the "shareholder primacy" fallacy, corporate leaders would think, and behave, very differently.

But let's go back to our listed tennis club.

As a shareholder, you're pretty happy because the club's courts are great.

But there are other shareholders that don't much care. They reckon they can get a higher return elsewhere. The share price tanks.

The tennis club doesn't want to get taken over, so it cuts costs to the bone, takes over other clubs to get economies of scale and expands into making tennis racquets. All to make sure it can maintain dividends.

This is the market at work and that's fine.

Structural problem

But herein lies the structural problem. There is always a relentless drive for higher returns. If you don't perform financially investors go elsewhere. The company is taken over or sold – I mentioned the great merger movement earlier.

Put all this together, and it is inevitable that listed companies will put profits first.

It is naïve to say things like "but the interests of customers and shareholders can be easily aligned … companies just have to look to the longer term".

Markets don't work that way. There will always be enough short-term investors to take their money elsewhere, forcing short-term, "shareholder first" thinking.

WHAT'S THE SOLUTION?

This means the solution lies in flipping the balance back.

Shareholder's interests should not be given more priority than those of anyone else: customers, workers or the environment.

To fix the problem we need to explicitly require large corporations – and the directors that run them – to act in the best interests of the community.

This change would be transformational. Profits would still come. But the question would no longer be "how do I make the most money", but "is this the right thing to do?"

And the people working in these organisations would gain a sense of real purpose.

We need to remember that incorporation is a great privilege bestowed by society.

- It allows companies to raise capital.

- And most important of all, it gives the gift of limited legal liability. If the tennis club goes belly up, I'm not responsible for its debts.

But with great privileges, come great responsibilities.

It would be so much better for all of us if this extraordinary legal structure - that of the incorporated company - led to community benefits, not detriment.

CONCLUSION

I said that I would begin and end this speech in the same place.

What I've argued is that we need to remember that we live in a community, not an economy. Everything we do should be for that benefit.

The change I've described - about requiring companies to make decisions in the best interests of the community - might seem radical.

All new ideas are at first, but that doesn't make them wrong. It just makes them worth debating.

I want to finish with a short quote from Professor Colin Mayer whose book "Prosperity", was one of the influences for this speech.

Professor Mayer wrote: "profit is only legitimate if it does not harm the rest of society." Those are wise words and well worth remembering.

Thank you.