Acting in the interests of shareholders matters

Henry Ergas 12:00AM September 20, 2019

The Committee for the Economic Development of Australia last week released the results of a survey of the attitudes the general public and corporate leaders have to business.

Launched to great media fanfare, Company Pulse 2019 contributed to a torrent of commentary about the need for companies to act more ethically.

The recent call by a bevy of American corporate titans for business to put greater weight on its social responsibility made CEDA's report even more newsworthy. However, entirely overlooked in the stampede was the fact that, far from having anything to do with ethics, the report's central results are all about entitlement and self-interest. In effect, its leading finding is not that companies should adhere to higher moral standards. Rather, it is that Australians believe companies should be run for the benefit of their employees.

Nor is that result a close thing. On the contrary, of the seven top priorities the public thinks companies should pursue, four involve improving conditions for those they employ.

As for increasing returns to shareholders, and so being able to fund expansion, that comes 25th in the ranking of priorities, well below paying higher wages, increasing the number of holidays, minimising redundancies, compensating staff for time spent volunteering, promoting workplace diversity and simply deciding to hire more people.

The actions that boost productivity — reducing costs, investing in new technology and increasing revenues — also trail the pack receiving, on average, a priority score less than half that of "investing in staff wellbeing".

To make matters worse, the trade-offs Australians accept are extreme: with "providing staff with a good work-life balance" (which leads the rankings) being held to be almost four times more important than returns to shareholders.

Companies should, it seems, be willing to give up a dollar in potential additional profits to fund 25c worth of improved conditions for workers — or so the report's methodology suggests.

Many concerns could be raised about those findings' credibility. It is, for example, hard to imagine that Australians would happily invest their own savings in firms that placed twice as much emphasis on "employing more people" as on "increasing returns to shareholders".

And it is equally questionable whether they genuinely expect employers to durably provide better wages and conditions if raising productivity gets as little attention as the rankings recommend.

But the scant regard the rankings show for shareholders' interests has an undeniable ring of truth to it. And it is made all the more plausible by the responses CEDA obtained from senior executives. Predictably, the business leaders put much greater weight on profitability than did the general public.

What is astonishing, however, is that only a quarter consider investors to be their primary stakeholder, which is well below the share who nominate consumers as the primary stakeholder and barely above the number who say it is employees.

Compounding the lack of concern for shareholders, business leaders said they felt a greater responsibility to "do the right thing" by employees and consumers than by the investors who own the business and give them their job.

And, topping it all off, executives and directors are much more likely than the general public to think that businesses, rather than just complying fully with social and environmental regulations, should "do as much as they can" to be "green" and socially aware.

In short, the foolish belief that the public service should be run like a business has morphed into the even more foolish belief that business should be run like the public service — with its senior managers enjoying the warm glow of virtue the public service attracts and the high earnings that being at the peak of the private sector brings. Forgotten in all that is why acting in the best interests of shareholders matters, not just for shareholders themselves but for society more broadly.

The point is as simple as it is powerful: when firms make large profits, it is usually because they are doing the public a substantial service. After all, so long as markets are tolerably efficient, and most product markets in Australia are, prices will broadly reflect the benefit consumers derive from the goods they buy on the one hand and the opportunity cost of the productive inputs used in their supply on the other.

As a result, a sizeable excess of revenues over costs means the enterprise is almost certainly putting much more value into society than it is taking out.

The amount consumers are willing to pay for the goods it produces significantly exceeds the value, in the next best use, of the inputs required to make them available.

The firm that boosts returns to shareholders by converting labour, capital and materials that would be worth only $1000 deployed elsewhere into

$2000 worth of products should therefore be celebrated rather than condemned; and it is surely the prospect of securing those profits that encourages the competition, innovation and risk-taking on which prosperity relies.

Unfortunately, stating that clearly and forcefully has joined the seemingly endless list of things that cannot be said, or that can be said only when the statement is drowned in mealy-mouthed qualifications that rob it of its bite.

And no one has proven less eager to bear the opprobrium of stoutly making the case on investors' behalf than our business leaders. It is hard, in observing that reluctance, not to be reminded of Vilfredo Pareto's famous analysis of the decline of elites.

When an elite basks in a prolonged period of easy living, the great sociologist and economist wrote, it inevitably "becomes softer, milder, more humane and so less capable of defending its own role". Yet, having convinced itself that it richly deserves every good thing life has to offer, "it loses none of its rapacity and greed".

The result is "on the one hand it makes the yoke heavier, and on the other has less strength to maintain it". Having succumbed in its "morbid sentimentality" to the desire to be loved, it no longer has the courage to justify its existence. Instead, seized by muddle-headedness, it ends up clamouring for the very laws that will precipitate its demise.

And, as it does that, Pareto concluded, it ensures that the public, rather than understanding the contribution it makes, turns on it all the more swiftly.

Nowhere are the dynamics Pareto described a century ago clearer than in the CEDA report. The last thing we need, its findings imply, is yet more undergraduate claptrap about ethics.

It is for Australian business to remember why it is there, and to choose life, instead of the assisted suicide towards which it seems so surely headed.