

SUPREME COURT OF NEW SOUTH WALES

ANNUAL CORPORATE LAW CONFERENCE

What is the Future of the Australian Business Corporation?

2019 Conference

Tuesday, 29 October 2019 at 1.35pm

Banco Court, Supreme Court of New South Wales,
Level 13, Queen's Square, Sydney

HER EXCELLENCY, THE GOVERNOR OF NEW SOUTH WALES:

36 Dr Austin, distinguished guests ,ladies and gentlemen,
37 it gives me great pleasure to introduce Professor Colin
38 Mayer, the Peter Moores Professor of Management Studies at the
39 Said Business School at the University of Oxford.

40

41 The Said Business School provides a transformational
42 experience led by and producing scholars with
43 transformational ideas. It is therefore fitting today that
44 Professor Mayer is the first speaker at today's conference.

45

46 Professor Mayer was the first professor at the Said
47 Business School, commencing in 1994. He became the
1 Peter Moores Dean of the Business School between 2006 and
2 2011, and the first Director of the Oxford Financial
3 Research Centre between 1998 and 2005. He has been
4 a Harkness Fellow at Harvard, a Houblon-Norman Fellow at
5 the Bank of England, the first Leo Goldschmidt Visiting
6 Professor of Corporate Governance at the Solvay Business
7 School, and has had esteemed visiting positions at
8 Columbia, MIT and Stanford, amongst other things that he
9 has done, and he currently leads the British Academy, as
10 the Chief Justice has indicated.

11

12 He is the author of "Firm Commitment: Why the
13 corporation is failing us and how to restore trust in it"
14 and "Prosperity: Better business makes the better good".

15

16 Professor Mayer's work and that of the Said Business
17 School featured in the Financial Times in August of this
18 year when the Financial Times reported and drew attention
19 to the fact that the Said Business School was calling for
20 business to reorient back to its historic roots, operating
21 to profitably meet the needs of society rather than of
22 shareholders. The theme or the thesis of that report was
23 that business schools must support firms and their leaders
24 to discern their purpose in the world and to act
25 accordingly.

26

27 I think, therefore, as the first speaker, we have
28 a very interesting launch of today's conference.
29 Thank you, Professor Mayer.

30

31 PROFESSOR MAYER: Your Excellency, Chief Justice,
32 honourable ladies and gentlemen, it is a very great
33 pleasure to be here. Thank you very much for your
34 introduction.

35

36 I am going to be talking to you about one of the most
37 important institutions in our lives. It is not the State,
38 religion, or indeed even the Supreme Court. It is an
39 institution that clothes, feeds and houses us, that employs
40 us and invests our savings. It is the source of economic
41 prosperity and the growth of nations around the world.

42
43 At the same time, it has been a cause of growing
44 inequality, environmental degradation and mistrust.

45
46 Every year for the past 35 years, Ipsos MORI, the
47 market research company, has undertaken a survey of 1000
1 people in Britain as to which professions they trust to
2 tell the truth. At the top, alongside doctors, nurses and
3 teachers, I am pleased to say come university professors.
4 We might not have much power, pay or prestige, but at least
5 people trust us to do nothing, earn nothing and take no
6 credit for it.

7
8 At the other end come business leaders, just ahead of
9 estate agents, professional footballers, journalists, and
10 rock bottom come politicians. They come below bankers and
11 the man and woman in the street. This has been a feature
12 of the survey every year since 1983 when it first started.
13 Mistrust in business is profound, pervasive and persistent.

14
15 Why is that the case? I would suggest to you that the
16 reason is what is sometimes termed "the Friedman doctrine",
17 after Milton Friedman, the Nobel Prize winning economist,
18 who said that there is one and only one social purpose of
19 business, to increase profits so long as it stays within
20 the rules of the game. That has been the basis of the
21 growing levels of mistrust of business to which I have just
22 referred. It has been the basis of business practice,
23 business policy and business education ever since.

24
25 But it wasn't always the case. The corporation was
26 established under Roman law to undertake a very public
27 function, of collecting taxes, minting coins and
28 maintaining public buildings. For nearly all of its
29 2000-year history, it has combined its normal commercial
30 activities with a public role.

31
32 The notion that there is only one purpose of business,
33 to make money, is something that has grown progressively,
34 in particular over the last 60 years since Milton Friedman
35 put forward his proposition.

36
37 It is likely to become a more serious issue, because
38 as technology accelerates, it not only offers tremendous

39 opportunities for enhancing human wellbeing, but it also
40 poses serious risks, and as technology accelerates, the lag
41 of regulatory responses behind business innovation
42 increases. For example, in relation to artificial
43 intelligence, it is not simply that that is going to have
44 a profound impact on manual labour; it will have an even
45 more significant impact on mental labour as machine
46 learning accelerates and machines are able not only to
47 assist us in making decisions, but take decisions for us,
1 not least in the boardrooms of companies. That raises very
2 profound questions about the algorithms that lie behind
3 those machines and the purpose for which they are
4 programmed.

5
6 Now, this is a subject that is rapidly changing. At
7 the beginning of this year, Larry Fink, the CEO and
8 president of the largest investment management business in
9 the world, BlackRock, said that every business needs
10 a purpose, not a strapline or a marketing campaign, but
11 a statement of its fundamental reason for being. Purpose,
12 he said, is not the sole pursuit of profits but the
13 animating force for achieving them.

14
15 As the Chief Justice just mentioned, in August of this
16 year the Business Roundtable discarded its 1997 statement
17 about shareholder primacy in favour of a statement of
18 corporate purpose, in which it said that corporate purpose
19 is about delivering value for customers, investing in
20 employees, dealing fairly with suppliers, supporting
21 community, sustaining the environment and creating
22 long-term value for shareholders. Last month the Financial
23 Times launched its largest campaign since the financial
24 crisis under the heading, "Capitalism: Time for a reset".
25 The editor, Lionel Barber, wrote to all of its readers
26 saying that the health of free enterprise capitalism
27 depends on business delivering profits with purpose.
28 Without change, he said, the prescription will be much more
29 painful.

30
31 Now, all of this reflects a growing interest and
32 concern about the reason why business exists, why it is
33 created, what it is there to do and what it aspires to
34 become - namely, the purpose of business. Everything -
35 business practice, policy and education - follows from
36 that.

37
38 The purpose of business is not just to produce
39 profits. The purpose of business is to produce profitable
40 solutions for the problems of people and planet. In the
41 process it produces profits, but profits are not, per se,

42 the purpose of business. Everyone who runs successful
43 businesses knows that to be the case, and they don't profit
44 from producing problems for people or planet. Instead,
45 what they do is they commit to a corporate purpose, and
46 they commit to those who help to create that corporate
47 purpose, and those people, in turn, help to commit to the
1 creation of a corporate purpose.

2
3 That gives rise to reciprocal relations of trust and
4 mutual benefits, both for the parties to the firm and for
5 the firm itself. It creates more loyal customers, more
6 engaged employees, more reliable suppliers, more supportive
7 shareholders and societies. That is associated with
8 greater revenues, lower costs and more profits.

9
10 Now, underpinning this is the trustworthiness of
11 business to promote those purposes and the ability of
12 companies to be able to commit to those purposes.
13 Underpinning that are the values and cultures of business:
14 values of commitment to corporate purposes and cultures of
15 honesty and integrity in so doing.

16
17 To address one of the issues that the Chief Justice
18 raised about the nature of purpose, let me just be clear
19 that a corporate purpose is neither just descriptive of
20 what a company does nor aspirational in terms of saving the
21 world. A corporate purpose is precise about what problems
22 it is there to solve, whose problems, how it is going to
23 solve those problems, when it is going to solve them and
24 why the company is particularly well suited to solving
25 those problems.

26
27 I want to illustrate this in relation to one example
28 of a pharmaceutical company, a very large producer of
29 insulin. It is a Danish company called Novo Nordisk.
30 A few years ago it realised that it was failing in
31 delivering its product to those people who were, in many
32 respects, most in need of it. Insulin is used for treating
33 type 2 diabetes, and 85 per cent of the world's type 2
34 diabetes is found in low- and middle-income countries, many
35 of which could not afford to purchase its insulin. So what
36 it initially did was to cross-subsidise the price at which
37 it sold insulin in developing countries from the profits it
38 was making in developed countries. That was quite
39 interesting, but not profound.

40
41 What it then realised was that its purpose was not
42 simply to produce insulin, its purpose was to treat people
43 who had type 2 diabetes. So it started working with
44 medical practitioners, doctors, nurses and universities

45 around the world to identify the best way of treating
46 type 2 diabetes, which might involve taking insulin but in
47 many cases did not.

1
2 And then it realised, well, actually, its purpose
3 wasn't simply to treat people who had type 2 diabetes
4 either. Its purpose was to help prevent people from
5 getting type 2 diabetes at all; and its purpose is now to
6 eradicate type 2 diabetes around the world.

7
8 So it then started to work with health workers, with
9 local governments, with national governments, to identify
10 the changes in lifestyles of individuals which would help
11 them to avoid getting type 2 diabetes.

12
13 Now, you might say, "Well, that's all very well and
14 very worthy, but doesn't it undermine the fundamental model
15 of Novo Nordisk?" The answer is no, it did exactly the
16 opposite, because in the process of building up those
17 relationships with health practitioners, workers,
18 governments and local authorities it became a trusted
19 supplier, and so its business has boomed on the back of
20 those relations of trust that it has built up with many
21 parties around the world.

22
23 Now, mention has been made of the fact that the
24 British Academy is undertaking a major program of research
25 on the subject of the future of the corporation to address
26 the economic, social, political and environmental
27 challenges it faces, as well as to take advantage of the
28 technological and scientific advances that are in progress.
29 Quite deliberately, the title is, "The Future of the
30 Corporation", not "business", to address precisely one of
31 the issues that the Chief Justice raised about the nature
32 of business where this is a particularly important issue,
33 and that is in relation, indeed, to the largest
34 corporations around the world. Because of the nature of
35 those businesses, they have the ability and the power to
36 influence our lives most significantly.

37
38 What The Future of the Corporation program did was to
39 identify a way in which we might think about
40 reconceptualising those businesses in such a way that they
41 perform somewhat more effectively in what we, as
42 individuals and societies around the world, need of them.

43
44 That reconceptualisation was exactly around those
45 three areas that I have just mentioned: the purpose of
46 business, why it exists and what it is there to do; its
47 trustworthiness to do that; and its values and cultures to

1 achieve that.

2

3 It has now, this year, gone on to set out four sets of
4 policies around which reform can, we would argue,
5 effectively take place. The first of those is, indeed, on
6 law and regulation. Law at the moment is predominantly
7 focused on the responsibilities and duties of directors of
8 companies to promoting the interests of their shareholders.
9 Important though that is, that is not the primary function
10 that the directors of companies should be focused on.
11 Their focus should be on the purposes of their businesses,
12 identifying their purposes and demonstrating that the
13 constitutions of their companies are aligned with the
14 effective delivery of those purposes.

15

16 Regulation is predominantly viewed as being in regard
17 to the rules of the game and the enforcement of the rules
18 of the game. Again, that is very important, but it is not
19 adequate in many circumstances, as we observe from the
20 repeated failure of regulation to achieve the desired
21 social outcomes in many industries, in many countries
22 around the world.

23

24 That reflects a failure to align the purposes and
25 objectives of companies with their objectives under
26 regulation and the conflicts that arise as a consequence of
27 that.

28

29 So the element of regulation that we regard as being
30 critically important in that regard is to align the
31 purposes of companies that do perform particularly
32 important public functions, namely, the commanding heights
33 of the economy - the utilities, the banks, the auditing
34 companies, public service providers, infrastructure
35 companies, regulated companies in general - where there is
36 a need to have an alignment between the private and public
37 objectives of companies.

38

39 There are ways in which those types of approaches have
40 been adopted. In particular, what is termed the Public
41 Benefit Corporation in the United States has been set up to
42 allow companies to incorporate with a public purpose
43 alongside the requirements on the directors of those
44 companies to promote their commercial performance.

45

46 That has a particular relevance in the circumstance in
47 which it is necessary to potentially align private and
1 public purposes of companies in regard to those commanding
2 heights of the economy to which I just referred.

3

4 The second area in which we have focused our attention
5 is in relation to the ownership and governance of
6 companies. Ownership of companies is predominantly viewed
7 in terms of the rights of shareholders. Again, important
8 though those are, so too, and increasingly so, are the
9 responsibilities and duties of shareholders in helping to
10 define the purposes and to achieve the implementation of
11 those purposes.

12

13 Those objectives are undertaken effectively in many
14 forms of ownership that one observes around the world,
15 in particular in the observation that the type of models of
16 ownership that one associates in particular with the
17 Anglo-American style of markets of dispersed ownership are
18 not those that prevail in all parts of the world.

19

20 To give you one illustration, there are forms of
21 ownership in Europe associated with what are termed
22 industrial foundations, which are companies that are owned
23 by foundations whose predominant purpose is to promote the
24 values and purposes of the businesses that they have
25 dominant shareholdings in. Nova Nordisk actually is a very
26 good illustration. It is a Danish company owned by an
27 industrial foundation that does ensure that there is a
28 consistency of purpose and values in that business.

29

30 Corporate governance is predominantly viewed as being
31 about solving what is termed the agency problem of aligning
32 managerial interests with those of their shareholders,
33 again an important function that it has performed in
34 particular since the Cadbury Committee met in 1992.

35

36 But in July 2018, the Financial Reporting Council
37 revised the UK corporate governance code away from the
38 notion that corporate governance is about aligning
39 managerial interests with those of their shareholders and
40 the notion that it is about aligning managerial interests
41 with the delivery of the company's purposes. Principle 2
42 of the Corporate Governance Code says that the board of
43 directors must establish the company's purposes, its values
44 and its strategy and ensure that they and its culture are
45 aligned. The directors should lead by example, act with
46 integrity and promote the desired culture. The next
47 principle goes on and says that the board of directors

1 should ensure that the company has adequate resources to
2 deliver on its objectives and measure its performance by
3 them.

4

5 Now, that sums up very well what this is really all

6 about. It is about companies defining their purposes and
7 ensuring that their strategy, their values and their
8 cultures, are aligned with the delivery of those purposes
9 and ensuring that they are investing sufficiently and
10 measuring their performance against the achievement of
11 those purposes.

12
13 That comes on to the next two elements which are
14 particularly important in the proposal, and that is in
15 regard to measurement and performance. Currently what we
16 predominantly measure are the physical and financial assets
17 of the firm, and that is basically what accounting
18 statements are about. Increasingly we have come to realise
19 that companies are no longer in many cases predominantly a
20 mixture of financial and physical assets, but they also
21 comprise their workers, their societies and their
22 environment and natural assets, many of which are outside
23 and not within the legal boundaries of the fold. We
24 therefore need to measure those just as we are measuring
25 their physical and financial assets.

26
27 Performance at the moment is measured in terms of
28 profits - profits net of the depreciation of the physical
29 assets of the company - but we should be measuring
30 performance also in terms of the extent to which companies
31 deliver on their purposes. To the extent that they fail to
32 do so or fail to maintain their human social and natural
33 assets, then there should be a provision in terms of the
34 cost associated with remedying or rectifying them.

35
36 The final set of areas relate to finance and
37 investment. Finance at the moment is very much focused,
38 and a lot of investor protection is predominantly focused,
39 on the rights of investors and the interests of investors,
40 but we are increasingly coming to realise that there is an
41 important role that the financial system performs in terms
42 of promoting the long-term financing of companies with
43 appropriate forms of risk capital. That financing is to
44 invest in not only physical assets within the boundaries of
45 firms to maximise shareholder value, but also to invest
46 throughout the supply chain and in the environment and
47 societies within which companies are operating in light of

1 the importance of those assets for the success of
2 companies.

3
4 Think, for example, of Amazon and Uber in regard to
5 human assets, or Google and Facebook in regard to social

6 assets, or airlines and energy companies in relation to
7 environmental assets and natural assets. What this
8 suggests is that if we are to bring about effective reform
9 of business, we have to recognise that what it involves is
10 essentially thinking about the nature of the purposes of a
11 business carefully and what is required to align the
12 achievement of those purposes with the structure of
13 companies and the way in which those companies measure and
14 incentivise people in their organisations.

15
16 I want to illustrate this quickly in relation to
17 another example, this time of a company that comes from one
18 of the least well-performing industries over the last
19 decade or so - at least in many countries around the
20 world - and that is the banking sector. I am going to cite
21 an example of what has been one of the most successful
22 banks in the world. It is a bank that earned steadily
23 increasing returns for its shareholders before the
24 financial crisis, during the financial crisis and after the
25 financial crisis; it has one of the best solvency ratios
26 and liquidity ratios of any bank; one of the best credit
27 ratings; it is a bank that has a clearly defined purpose
28 that puts the interests of its customers first; it also
29 seeks to have one of the lowest cost bases of any of its
30 rival banks and it has been very successful over 44 years
31 in achieving both of those things.

32
33 It is one of the fastest growing banks in Britain, but
34 it is not a British bank, it is a Swedish bank called
35 Handelsbanken. Indeed, it has had some of the most
36 satisfied customers of any bank and also some of the most
37 loyal customers, which brings out this important notion of
38 reciprocity to which I was just referring - namely, look
39 after your customers and your customers look after you.

40
41 What is a key feature of this bank is the way in which
42 it governs its activities. Many of the largest
43 international banks around the world have increasingly
44 centralised control at the top of their organisations, not
45 least spurred on by regulation to do so. This bank does
46 exactly the opposite. It delegates decision-taking down to
47 the level of individual branches to a point that the mantra

1 of the bank is "the branch is the bank". It gives
2 discretion to the branch managers of the bank to determine
3 which customers they are going to deal with, what products
4 they are going to sell them, what price they are going to
5 charge, and whether or not they are going to give them a

6 loan, et cetera.

7

8 The importance of that delegation of decision-taking
9 is that it gives discretion to those in the branches to
10 make decisions. They do not have to refer everything up,
11 wait for a decision and then have to tell their customer,
12 "I'm terribly sorry, you can't have your loan". That has
13 been the basis on which it has been able to build up those
14 relationships that have been so important to the success of
15 the bank.

16

17 What underpins this is the way in which the bank runs
18 its own activities. It is a humane bank by construction
19 not just in terms of its customers, but also in terms of
20 the people who work in the bank. By that, what it means is
21 that it pays a lot of attention to how it selects people to
22 work and run its branches. It instills the values of the
23 bank firmly into those branch managers and then it says,
24 "Get on and run your branches". It does not incentivise
25 people to do that. It is a bank that pays no bonuses to
26 its employees. Remember how we are continuously told you
27 have to pay bonuses to bank employees if you want to retain
28 and recruit them. Well, it pays none and it is one of the
29 most successful banks in the world. Except for the fact
30 that it pays a bonus when people retire at the age of 60.
31 It is a very long-term incentive scheme.

32

33 Now, that brings me on to the final point, because
34 when they retire at the age of 60, people get a share in
35 the profit scheme of the bank called Oktogonen. Oktogonen
36 is one of the main shareholders of Handelsbanken.
37 Handelsbanken is listed on the Swedish stockmarket and it
38 actively trades, but it has two major shareholders, of
39 which Oktogonen and the profit-sharing scheme is one and
40 the other is Industrivärden, a Swedish industrial holding
41 company. If you pose the question who is the main
42 shareholder in Industrivärden, you've guessed it, it is
43 Handelsbanken. It is a cross-shareholding. It is the
44 worst form of corporate ownership and governance you can
45 imagine, only it has been associated with the most
46 successful bank.

47

1 That is one of the main points I want to convey, that
2 many of the notions that we have about what's right and
3 wrong in terms of successful business, they are just not
4 borne out by looking around the world at what makes for
5 success.

6

7 This brings me on to the final issue that the
8 Chief Justice raised about the impact of this for our
9 capitalist systems. Capitalism, as it is conventionally
10 considered, is an economic system of private ownership of
11 the means of production and their operation for profits.
12 Ownership in this context is a bundle of rights that
13 confers strong forms of authority on their possessors, and
14 firms are nexuses of contracts managed by the boards of
15 directors for the benefit of their owners.

16

17 Now, that is a coherent, consistent view of what
18 capitalism is. It is about ownership for profit managed by
19 directors that employ the rest of us through contracts.
20 But I suggest to you that there is an alternative view of
21 what capitalism is about, and that is that capitalism is an
22 economic and social system for producing profitable
23 solutions for the problems of people and the planet, by
24 private and public owners who do not profit from producing
25 problems for people or planet.

26

27 In that context, ownership is not just a bundle of
28 rights, but a set of obligations and responsibilities to
29 uphold those purposes. Firms are not just nexuses of
30 contracts, but nexuses of relations of trust based on
31 principles and values enshrined by the boards of directors.

32

33 That, too, is a coherent, consistent view of what
34 capitalism is about. It is about solving problems by
35 owners and directors who engage the rest of us through
36 relations of trust as well as contracts. What underpins
37 the conventional view of capitalism is that it is sustained
38 and aligns its interests with our interests through
39 competition - competition in markets for products, for
40 labour, for finance - and where markets fail, we turn to
41 regulation and competition policy.

42

43 Now, what this is suggesting is that between market
44 efficiency and regulatory effectiveness, there is a void
45 that is increasingly becoming a chasm as technology
46 accelerates where both markets fail and governance and
47 regulation fail. In that void, we rely on business to

1 transform our individual self-interest into a collective
2 cooperative interest in a common purpose.

3

4 Indeed, there is an alternative in which that does not
5 happen, and instead what happens is we experience ever

6 intensifying regulation, and that is indeed what is
7 happening in most countries around the world and, for
8 example, is a likely consequence of the Commission that's
9 just happened in relation to the financial sector here in
10 Australia. But it is not a happy outcome, because it is
11 costly for everybody and at the end of the day, as we have
12 discovered as we go through that process in the UK over the
13 last 10 years, it does not really work, or indeed in the
14 US.

15
16 There is an alternative which recognises that what
17 really makes for successful business is the trustworthiness
18 of business and the extent to which it has an element of
19 integrity in terms of being a coherent integral whole that
20 is consistent with what is required, not only to deliver a
21 profit, but also what we as individuals and societies need.

22
23 Ultimately, trustworthy businesses are commercially
24 successful businesses and the competitiveness of nations
25 depends on the trustworthiness of its business for the
26 prosperity of the many, not just the few, of the future as
27 well as the present. Thank you.

HER EXCELLENCY: Thank you, Professor Mayer. I think you
30 have already thanked him in the usual way. I think you
31 have set the bar at just the right level. Thank you very
32 much.

33
34 DR AUSTIN: Thank you. While the Governor and
35 Professor Mayer are taking their seats, I will introduce
36 and call upon the speakers in the next session. The
37 speaker is Justice James Edelman of the High Court, and the
38 Chair of the session is the President of the Court of
39 Appeal. They should take their places at the bench.

40
41 I should say in relation to Professor Mayer's
42 remarkable presentation, not a word of the Chief Justice's
43 challenge was conveyed to him before the event. So we have
44 the Chief Justice setting the scene, laying down the
45 gauntlet, and we have a reply. I am sure you are all
46 considering carefully how to evaluate them. Thank you.
47

