Corporate Goals[1]

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Introduction: Changing Corporate Goals

The papers of professors Richard Sylla, Lynn Stout, and Edward Wolff have described the forces that have moved our American corporations away from the once dominant "stakeholder" view of their goals and purposes. This older view took into account the often conflicting interests of employees, shareholders, community, and even county. Today's dominant shareholder view is that corporations should have an almost exclusive focus on profit, on creating value for shareholders.[2]

The effect we can expect from such a significant shift of direction by the great productive engines of the country depends very much on who the shareholders actually turn out to be. If it is the case that share ownership is widely distributed among Americans, gains in value for shareholders would be gains in value for a broad section of the American public. However, if share ownership is highly concentrated in some fairly narrow group, we would have a very different outcome.

The work of Professor [Edward] Wolff[3] has shown that stock ownership is, in fact, highly concentrated. The wealthiest 1% have about a third of the value of all shares, and the top 5% have about two thirds of the value. The remaining third is spread over the remaining 95% of the population. So in taking the increase in stock price as their main goal, our great companies have, in fact, dedicated themselves to making the wealthy wealthier.

1 Read 16 November 2013, as part of a symposium on American corporations.

2 This view is so dominant that most corporate directors think that aiming at maximizing shareholder value is a legal requirement, which it is not. See Stout, Lynn. *The Shareholder Value Myth*, Berrett-Kohler Publishers, 2012.

3 Wolff, Edward. "The Asset Price Meltdown and the Wealth of the Middle Class." NBER Working Paper, No. 18559 (November 2012).

Time Period	% Productivity Increase	% Wage Increase	Top 1% Share of National Income
1949–1979	119	100	9–13
1979–2009	80	8	23

Table 1.

In this new situation, stockholders and the top layer of corporate management, which is now compensated primarily by stock options, have a common interest: holding down wages in the interest of greater profit. This is very different from the earlier pattern of sharing with employees the gains from productivity. And the historical record now shows us the result of this change.

What Has Happened[4]

The year 1980 is often taken as the beginning of the change in corporate goals, and if we compare the decades before 1980 with the decades from 1980 to the present, we do see a striking transformation.

Table 1 shows two very different outcomes. For the three decades 1949 to 1979 that preceded the change to shareholder value, we have a fairly simple picture: the country grew and most people's wages grew with it.

During that period, productivity rose 119%, compensation of workers grew at a rate that was slightly lower (about 100%), and the share of national income received by the top 1% of earners ranged from 9% to 12%.

But over the next three decades (1979–2009), as the shareholder focus took hold, the results were very different. In this period, although productivity rose 80%, worker compensation rose only a small fraction of that, and the top 1% roughly doubled their share of the national income.

The change in corporate goals has brought us into a very different world—a world in which the gains from productivity are almost all going to a narrow top tier. We need to ask if this is what we want of our corporations, and if it isn't what we want, we need to ask if we can do better.

4 For a more careful view of these developments, see Gomory, Ralph and Richard Sylla. "The American Corporation," *Daedalus* 142, no. 2 (Spring 2013): 102–118.

Why Do We Have Corporations?

As a first step, let's consider this question: Why do we have corporations at all?

We clearly need some kind of large organizations to create the complex goods and services we require in the modern world. It takes a large organization to mass produce a car, or provide a wide-ranging wireless service, or run even a regional airline. This is not something a person or small group can do on their own.

This need for large organizations is very different from the situation that prevailed before the Industrial Revolution. In that world, almost all economic activity was carried out on small farms and small shops. Large organizations, except for armies, navies, and religious orders, were few and far between.

When corporations carry out their function of creating today's complex goods, they are creating something of value. Can we measure the value they create? And if we can, we could consider maximizing the value they create as a corporate goal instead of the current dominant goal of profit, which today distributes the gains from productivity away from most Americans.

Measuring the Value Corporations Create

Let us start with a concrete example: a corporation that builds and sells cars. The revenue the corporation receives is what purchasers pay for their cars. Is that revenue a good measure of the value the corporation has created?

A moment's thought will tell us that using the corporation's revenue as the measure of the value created has a problem: the company did not produce cars by its own actions alone. A car maker might buy steel from a steel mill, use electricity from a power company, and purchase an electronic guidance system from an electronics company and tires from a tire company. The car maker acquires these items, then, using its own work, skill, and knowledge, transforms a bundle of parts into a car—the final product that gives them revenue.

The value they have added, the value they have created by their own actions, is better measured by taking the revenue for the car and subtracting the cost of the various parts purchased from outside the company than by taking revenue alone.

Let's look at another example: the value a supermarket creates.

When we check out at a supermarket, we pay the supermarket for a basket of goods, and that payment is their revenue. But the supermarket

did not create those goods. They are obliged to turn around and pay most of that revenue to the companies that supply them with those goods. They also pay rent if they don't own the supermarket building, and they consume electric power. Again, the value the supermarket has created is only the difference between what they get in at checkout and what they pay out to their suppliers.

The supermarket has created value, not by making those products, but by spreading the products out on their shelves, marking them with prices, and providing carts and checkout. They have succeeded in making, in one place, a great assortment of their suppliers' goods readily available to customers.

The value they have created is the difference between their revenue from checkout and what they pay their goods suppliers, for store rent, and for other inputs from outside their company.

It is from that value that they have created that they pay their employees' wages, provide profit for their shareholders, and pay their various local, state, and federal taxes.

Defining Value Added

In both the car company and supermarket cases, the revenue less the cost of goods or services acquired from outside the company is called the *value added of the company*. It is a well-known accounting term, and it matches pretty well what you would want to think of as the value created by the corporation.

So in value added, we do have a reasonable measure of what a company contributes.

The Value-Added Corporation

Now that we have this measure, let's take a hard look at something we can call the *value-added corporation*, a company that takes, as its goal, not profit maximization but rather maximizing its *value added*, the measure of its contribution to the world.

That value added by a corporation is what it has available to pay its workers, its taxes, and whatever other internal expenses it may have, as well as contribute profits for the shareholders. But all these items, wages, taxes, and profits are in conflict with one another. If taxes can be avoided, there is more for wages and profits, and if wages are lower, there is more for profits.

However the value added, which is now what the corporation is maximizing, is always the same no matter how it is divided up. So in

the value-added corporation, we have automatically separated the goal of the company from the question of "Who gets what part?" of it. The focus on maximizing value added is a focus on making the total pie as large as possible. The size of the various slices is a separate issue.

Value added as a goal also makes sense at the national level. It is not hard to see that the value added by all the corporations and other organizations adds up to the *national income*, or the total value of all the goods and services created by the country. And increasing national income through greater productivity is a familiar and worthwhile national goal.

Now we can discuss the division of value added. That division among the claimants can be different in different companies. In a world of companies devoted to maximizing value added,[5] some companies will give as much as they can to profits, making them look very much like today's profit maximizing corporations; these companies may find it easier to raise money in the stock market. Some companies may choose to give more in wages, and they may find it easier to hire and keep good people.

Different divisions of value added will give companies different competitive advantages. But whatever choice a company makes, we know that they are all contributing as much as possible to the national income.

Different Forms of Organization

For a value-added corporation to remain a value-added corporation and not be available to be bought up and converted into something else, it will need a form of governance that is different from the ordinary governance of most publicly traded corporations.

But different forms of governance are not new. Different forms of large organizations—namely, mutual corporations and cooperatives—have a significant history in the United States and even more abroad. In the insurance industry, the *mutual form*, in which the insured are automatically the only shareholders, today serves more than 135 million auto, home, and business policyholders. Its board is elected by the insured. Cooperatives have had a significant presence in agriculture, farm credit, federal home loan banks, rural electric service, and credit unions. These organizations are not easily taken over by outside shareholders.

Value-added corporations will probably need to have governing boards that represent all the major claimants to shares of the value

5 Or some variant of it like maximizing value added per capita.

added. Certainly both employees and stockholders will need to be represented.

Recommendations for Change

Proposals for change in the U.S. economy can take many forms. Many such proposals require some federal action; often, this is a tax incentive. The Research and Development (R&D) tax credit is a familiar federal tax incentive aimed at producing more R&D. A more progressive federal individual income tax is another familiar proposal, aimed at reducing disparities in income and hence eventually in wealth.

Federal action could certainly play a part in affecting the sort of change we are discussing. There was, in fact, federal legislation in 1993 that limited corporate tax deductions of large executive salaries. But although this did affect top corporate salaries, it had no effect on executive stock options and may even have hastened the trend of tying the bulk of executive compensation to stock price.

However, it is extremely unlikely that anything can be done through federal action, given the enormous influence our present profit-maximizing corporations have over both parties in Washington D.C.

But federal action is not required to create different types of corporations, such as the value-added corporation. Any person or small or large group can start a corporation of any form; any group that controls the voting shares can change an existing corporation.

For example, why not have a bank that disclaims the use of derivatives and trading with depositor's money and limits itself to the constructive business of making loans to business and individuals? Such a bank might appeal to both depositors and clients. Many people might prefer using its credit card to their present alternative of giving their money to today's dominant financial institutions.

If we develop many value-added companies in our economy, we might become a nation with a great variety of companies, but all adding as much as they can to the national income and many adding to a better distribution of income, wealth, and, in turn, political power.

Different Goals, Different Effects

It has been observed, quite correctly, that every dollar of corporate profits ends up in someone's pocket. But it is also true that every dollar of wages ends up in someone's pocket. And they are very different sets of pockets.

In today's world, being part of a large organization is what most

people must do to earn a living and support themselves and their families. It is time for us to have some corporations that are structured to take this into account and make wages as high a priority as profits.

While I have emphasized the value-added corporation, there are many other forms of organizations that can be considered and tried. The profit-maximizing corporation is very far from being the only way, and there may not be any one best way, but rather many that are better than what we have now.

Human Nature: More than Money

We should also realize, as a practical matter with practical consequences, that there is more to human nature than the quest for money. Real people, as opposed to the purely economically motivated people of economic theory, are likely to prefer spending their working lives with companies that maximize the value they create (or some other constructive goal) than with companies whose goals are to hold down wages and avoid taxes in the name of profit maximization.

Curiously enough, both Darwin and Adam Smith, in parts of their works that are almost never referred to, were fully aware that human nature includes an inherent desire to contribute to the well-being of others.[6] Companies that appeal to this aspect of human nature, as well as to the reasonable needs of the individual, are likely to outperform those that pay no attention to this side of human nature.

Summary

The great American corporations may be doing well for their top managers and shareholders, but this does not mean that they are doing well for the country as a whole. The present corporate focus on profit threatens both the long-range productivity of the country through extensive profit-driven off-shoring and its long-range internal stability through the concentration of wealth that carries with it the danger of political and economic dominance by a few.

It is time to consider change.

The viewpoint advocated here is not new; rather, it is the exclusive focus on shareholders that is new. In support of this final point, I will end with a quotation:

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6 See Gomory, Ralph, "Put Human Nature Back in Business", *Washington Post,* op-ed, June 28, 2013.

> Great corporations exist only because they are created and safeguarded by our institutions; and it is therefore our right and our duty to see that they work in harmony with those institutions.

This is not a quote from some Wall Street occupier or left wing radical. It is a quotation from the first annual message to Congress (1901) of President Theodore Roosevelt.