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Profit and Purpose: Understanding the Social Function of the Firm

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Abstract

The conventional business model views a firm's short-term profit maximization as its only purpose and measure of success. At the end of the 19th century, Henry George analyzed the paradoxical trend of increasing inequalities in a period of rapid industrialization and growing corporate profitability. Today, the problem has risen again to the top of economic policy and academic discussions. The concerns revolve around enacting reforms of corporate governance structures consistent with a socially conscious business model. Reflecting on these topics, a new business model has begun to evolve in parallel with what has become known as the Stakeholder Approach. Increasingly, businesses are abandoning the one-sided focus on short-term profit maximization and implementing long-run measures for positive social impact. These firms embrace concepts such as sustainability and stakeholder capitalism. Evidence shows that firms that act ethically create sustainable prosperity both for themselves and for their employees and communities. This paper reviews previous theories of the firm, their shortcomings, the success companies achieve from embracing the new social paradigm for business, the organizational entities that may facilitate a transition to a socially conscious corporation through ESG measures that support stakeholder interests, and the organizations that measure businesses' environmental and social impact.

Keywords: Business model, Corporate governance, Corporate social responsibility, dual target corporation, ESG, German Co-determination system, Management, Shareholder, Stakeholder corporation, ESG, German Co-determination system, Management, Shareholder, Stakeholder

I. Introduction

As inequality continues to widen and society becomes more polarized, it is clear the current philosophic grounding of the purpose and governance structure of the firm needs rethinking. For too long, the conventional purpose of the firm has been narrowly framed through short-term profits by any means necessary. Such short-termism has also become dominant in regard to equity holdings of firms (see Semmler et al. 2022). As long as corporations' profits grew, and there was a return on investment for the shareholders, the externality effects and damages their operations caused seemed to be rationalized along the lines of the Coase theorem. However, alternatives to this model have begun to emerge.

After all, profit should not be a purpose in and of itself. It is but a resource to achieving its purpose. Whether the purpose concerns the production of mayonnaise or how well people from across the world can be connected, profit is a means of achieving an end, defined by a firm's mission (Wolf 2018). By utilizing its profits, a firm can continue to innovate in order to continue investment and maintain broad growth.

Other cultures have similar philosophies baked into their economic history. Take Japan, for example, where "since ancient times, Japanese business operators have always been mindful of working for the benefit of a wide range of stakeholders, rather than merely pursuing their own short-term gain, and thereby contributing to society at large" (Kiuchi 2022). Moreover, one of the most impactful business leaders of 19th-century Japan was Eiichi Shibusawa, whose catchphrase was: "the origin of wealth is humanity and morality." Shibusawa founded hundreds of corporations (many of which are still operating today), such as Oji Paper, and was a primary influencer in early Japanese capitalist policy. His ideas are interwoven in the egalitarian society of today's Japan, including flat wage differentials, universal healthcare, education, and a focus on opportunities for people to live happily (Fridenson and Takeo 2017). "Shibusawa's goal was to create a fair and inclusive economy that would enrich the lives of a broad range of people and provide them with various opportunities," according to Prof. Christina Ahmadjian of Hitotsubashi University (Ahmadjian 2022). Another important example of the socially oriented firm is the German co-determination system, to be discussed below. Recent shocks to the global economy have presented an opportunity to rethink the purpose of business and corporations.

The COVID-19 pandemic and its resulting social and economic crisis has exacerbated the problems of poverty, inequality, and the functioning of markets across the world. The pandemic has exposed the unequal access to healthcare experienced by lower-income groups, as well as minority groups, in addition to depressing economic outcomes for many. It not only caused a decline in economic and social status for many, but also left this fraction of the population vulnerable to the subsequent economic and social crises.

A growth in economic activity in early 2021 after vaccine rollouts and the end of "zero Covid" policies have opened up an opportunity for policy makers not only to consider innovations in public policy, but also to turn their attention to the governance of corporations, the dimensions of the social imprint of corporations, and bigger issues such as climate change. Private companies, on their part, have been actively managing their ESG reputations through social media and some, in practice, by changing and adopting new, more nuanced management and production practices. Collectively, the success of such initiatives may accelerate the institutionalization of novel decision-making practices across private businesses together with a re-prioritization of the firm's social impact. New terms found across business media these days, such as benefit corporations, Environmental and Social Governance (ESG), and stakeholder capitalism, could suggest a shift in the operational model from one with narrowly defined corporate financial targets to one that encompasses more humane aspects of the well-being of employees, suppliers, and communities. As such, the social purpose of the corporation has become an increasingly debated central theme in academic and policy circles.

While ESG has become a highly uncertain topic, it has grown in importance across every industry. The social and economic pressure comes from activist investors in financial brokerages and from some increasingly socially conscious consumers shaping the argument for sustainable and responsible corporate practices. Calls are growing, from both investors and the public, for corporate executives to adapt to these socially conscious practices in order to satisfy the many interests involved. These different interests are known as stakeholders.

To understand how a typical enterprise could satisfy its stakeholders, one must begin to reexamine the philosophy that has defined global capitalism as it is generally known. Clearly, the social role a firm has within its local, national, and global communities is undeniable, and therefore must be given greater ethical consideration. But is this how individual corporations see themselves?

Milton Friedman's work shaped the more conventional view of a business for the sake of profit. A social purpose-driven firm is not necessarily a new idea. At the same time, recent advocates for a social purpose-driven firm include Muhammad Yunus' proposal for a Social Business, which has only now begun to penetrate the mainstream. We argue that a company driven by wider and more long-run purposes, as opposed to short-term monetary enrichment, will help alleviate the rising inequalities and social pressures mentioned above. Just think of all the good that could be achieved if multinational corporations put their resources towards overcoming social ills. Such a view represents a paradigm shift from Friedman's position and is the main focus of this paper.

II. Analysis of Stakeholders and Shareholders

This section focuses on two key groups of economic actors and the differences between them: shareholders and stakeholders. The former has been at the center of the philosophical underpinning behind old notions of the firm while the latter allows for a more inclusive and democratic approach to governance and decision-making.

A well-known definition of a shareholder states that it is anyone who has (partial or full) ownership of property or a company and participates in the division of value derived from the assets upon dissolution (Hill and Hill 2022). Often, the term stockholder is used interchangeably with shareholder. In either case, the terms refer to owners of property with certain legal rights and protections granted to them (Friedman 1970).

A stakeholder, on the other hand, is an economic agent (individual, community, or entity) that is impacted by the decisions made and policies implemented by a firm (Richter and Dow 2017). Stakeholders may include employees, shareholders, suppliers, communities, and the environment. Conceptualization of "stakeholders" should be broad, but not so broad as to include everything and anything. In order to avoid including unnecessary entities as stakeholders, boards

ESG, as previously mentioned, is a framework used within business and economics to measure the impact a firm has on its stakeholders (i.e. the environment and the communities it operates within), as well as to assess the institutional aspects of corporate operations (governance). While the main focus here is on ESG, it should be understood that there are other similar frameworks that offer contemporary guidance across more specific areas and with nuanced perspectives (e.g., innovative indices, environmental compliance, etc.).

One of the factors affecting the impact on stakeholders is short-termism. It is generally argued that short-termism, often referred to in economics as myopia, is a mindset held by corporate decision makers and across policy circles in which long-term goals are sacrificial to immediate goals (McNeill and Johnson 2018, 6; Semmler et al. 2022). Often, such an orientation leads to a firm engaging in practices that are potentially harmful to the long-term sustainability of operations and with limited benefit to their stakeholders (Strine 2020, 3). There are many such examples across all industries.

The story of Enron is a perfect example of the dangers of short-termism. The governance structure, corporate culture, and desire to maximize short-term profits above all else led to its inevitable downfall. Profit maximization required unethical accounting practices and fraud that made the firm look like it was doing better than it actually was (Bondarenko 2016). As competition set in, decreases in profits had outsized effects. Once losses were posted and scrutiny intensified, the company began to fail and eventually filed for bankruptcy (Bondarenko 2016). The social impact was clear: 4,500 Enron employees lost their jobs and the 24,000 participants in its retirement plan lost a collective $1 billion (Foss 2002).

It is also crucial to understand how barriers to entry can be used to prevent the socially oriented firm from succeeding. Barriers to entry are the costs associated with entering a market or starting a business. In this context, however, we are mostly discussing how monopolists can create or increase such barriers in order to prevent or eliminate competition. The barriers may come in many forms: default provisions (e.g., Google's status as Apple's default search engine), duplication of competitor products and services, price gouging, prohibiting competitors from buying a particular production input, entry-preventing investments, unscrutinized markups, or access to and misuse of competitive intelligence (Kwoka and Valletti 2021, 9).

We argue that a stakeholder model can have better social outcomes for the broadest range of interests possible. It may be argued that before shareholder primacy took hold, it was common for executives to consider all their stakeholders. In such cases (before World War II and the advent of short-termism), mutual benefit was derived/gained: when a firm did well, so did the community and individual, and vice versa (Schwab and Vanham 2021, 3). But when the firm pursues short-termism in a predatory manner by cutting costs through withheld wage growth or minimizing benefits, it is siphoning away value that could be shared with a large community, their stakeholders.

Other important groups of actors, from an ESG perspective, are the rating agencies and stakeholder implementers. These agencies track and rank the ESG policies enacted by corporations. Some take a quantitative approach, such as JUST Capital, which rates corporations against one another. Alternatively, there are agencies that take a qualitative approach, such as the Sustainability Accounting Standards Board (SASB), which shows the environmental and social efficacy of each individual firm's actions. Since one is not necessarily better than the other, and they have different models and standards of measurement, it is important to include different types of rating agencies within analysis. In fact, the ESG decision- and policy-making of the firm is currently driven mainly by the different standards and ethical perspectives of the rating agencies.

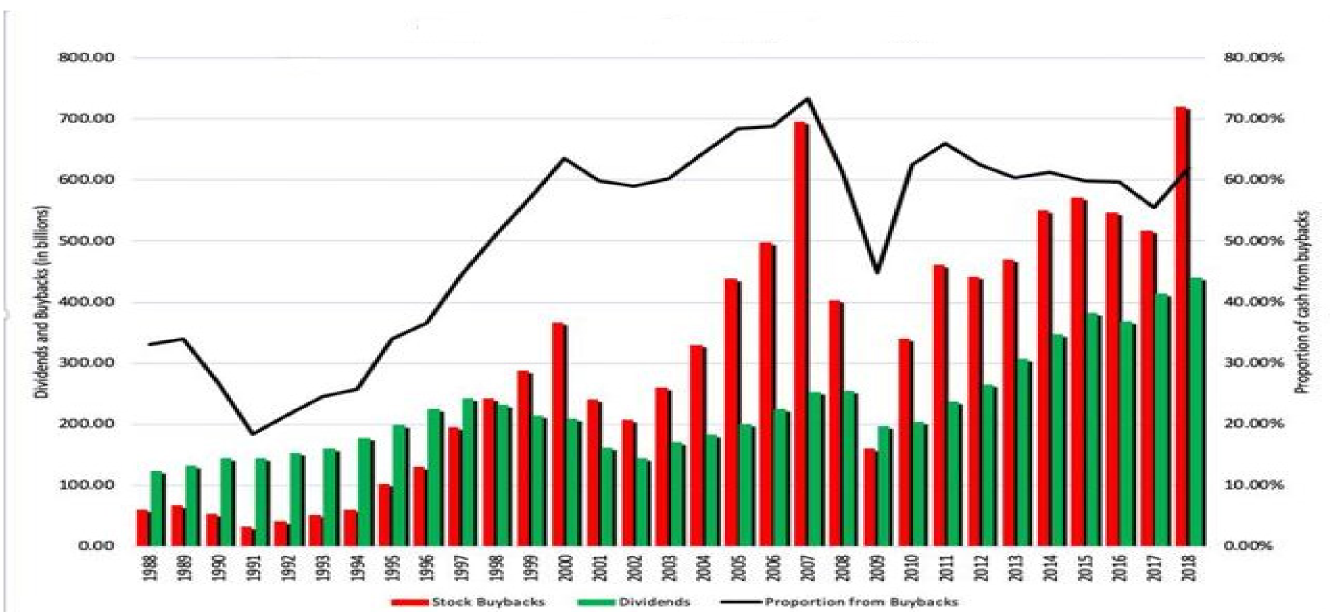
III. A Critique of Current Theories of the Firm

The current framework for understanding a firm's role in the economy originated during the 1970s from the famous economist Milton Friedman and his Chicago school cohort. These economists had a narrow view of how the firm functions within society. The policy they inspired, be it regulatory, economic, or judicial, created an unrealistic vision of how the firm interacts within the economy and society.

The philosophy behind this current framework interprets the purpose of the firm in terms of short-term profit maximization. The notion of shareholder primacy emerged from the idea of profit maximization. The conventional view is that a firm should 1) dedicate all of its resources and abilities towards generating the highest profit possible and 2) appropriate, as profits, the entirety of the surplus it generates, and then turn it over to its shareholders in the form of dividends. Unfortunately, the proportion of these profits paid out to shareholders has never ceased to increase.

The use of profits to increase dividends, as well as stock buybacks, only siphons off the resources needed for growth. Instead of profits being retained for innovation, they are distributed and relinquished. Over time, both dividends and buybacks have increased, both in real terms and as a percentage of cash returns, as can be seen in Figure 1 (Damodaran 2019). Because resources are scarce, increasing payouts will sap resources from the innovation strategy created by the firm and will force it to pursue much riskier strategies in order to continue growing, such as taking on more debt.

Figure 1: Dividends and buybacks—S&P 500 Companies
Source: Damodaran 2019



Proponents of this philosophy argue that if the firm does not maximize profits and does not distribute them to shareholders, the innovative drive behind business growth will suffer and the tremendous technological advances that have improved living standards over the past three hundred years will come to an end (Jensen 2001). But the broad march of laissez-faire economics across nations (Gevorkyan 2018) and, through recent history, shareholder primacy has generated steep asymmetries in wealth distribution and radicalized social divisions (Harvey 2005, 87).

In Friedman's eyes, the firm acts like an individual. By this logic, if the firm is not harming others while profiting, it is operating morally and correctly. For Friedman and his followers, the only means of determining a firm's social impact is through prices. They do not consider the broader implications of the long-run (not directly commercial) effects businesses have on society.

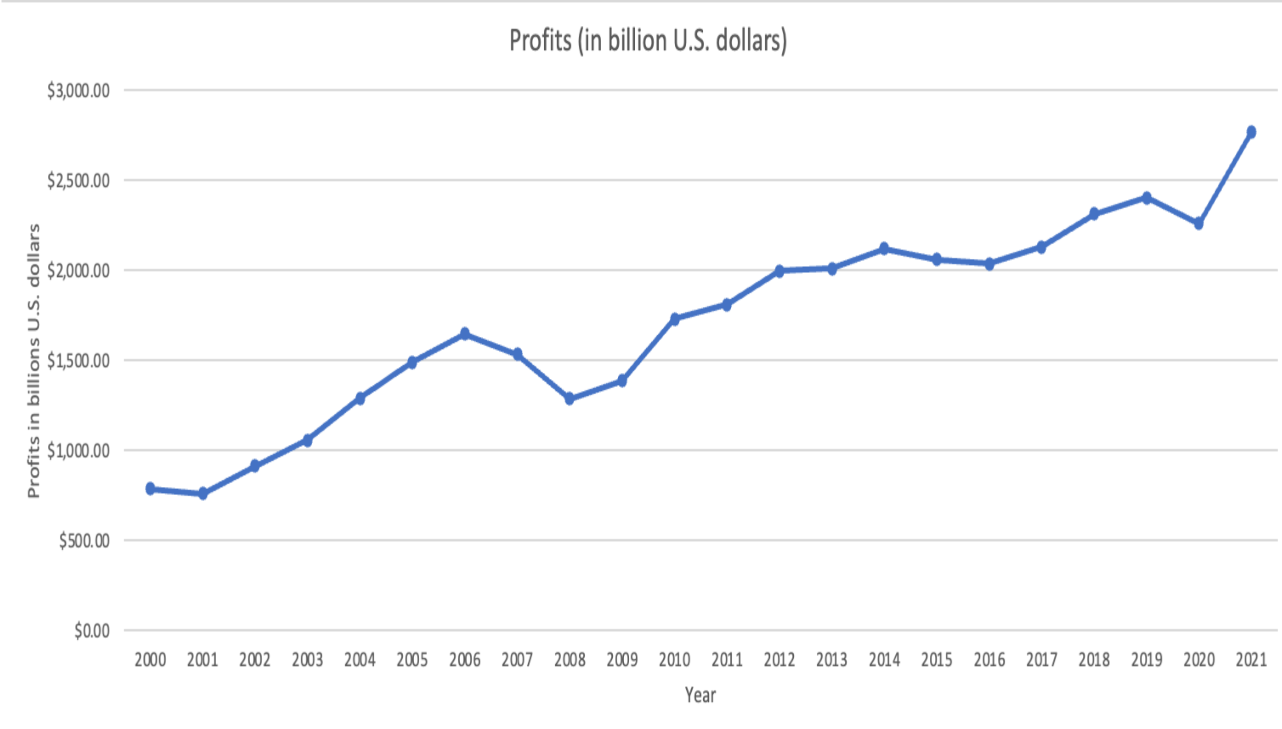
In his New York Times essay, Milton Friedman claims, "[t]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception fraud" (Friedman 1970). Today, this is known as the Friedman Doctrine. Its subscribers hold tightly to the doctrine and see very little social purpose for the corporation, if any at all. The corporation is viewed as a "nexus of contracts" with a diminished role within society as a rule-taker, meaning it abides by the rules but does not make them (Friedman 1970).

Friedman's followers from the Chicago school have inspired a generation of economists and policymakers who have created an economic framework that emphasizes consumer welfare. But consumer welfare is judged through the narrow lens of price theory, which focuses on the effect prices have on consumers (Khan 2017). However, this leaves out important factors for examination, such as competition, markups, or market concentration. Competition is the idea of firms vying with one another for the patronage of individuals. Market concentration refers to the share of the market captured by a firm. Massive corporations are now able to forgo profits temporarily for the sake of competition and market concentration, and survive through revenues and previously generated wealth. This gives the firm tremendous power both inside and outside of the market—inside through its massive size and ability to remove competitors, and outside via increased lobbying influence throughout policy-making circles (Semmler et al. 2022, 179-190). Since the start of 2021 alone, large tech companies have bought 9,222 startups with an individual value of less than $1 billion (Stacey et al. 2021).

There are two main problems with the price theory approach to antitrust (i.e. regulation of market competition) that have massive societal implications. First, it ignores profits and focuses on revenues by allowing companies to cut prices low enough to eliminate rivals. Huge corporations can easily enter markets, increase the barriers to entry to an extraordinarily high level, and keep prices temporarily low in order to massively increase their market share with minimal damage to revenues (Cain Miller 2010).

They are able to enter and dominate markets so easily because they have enormous revenues, extensive borrowing power, and can afford to take losses for a sustained period of time while still growing (Khan 2017). This has given larger firms outsized market power, in recent times in particular, leading to record levels of profit, as seen in Figure 2, and decreasing competition (Philippon 2019).

Figure 2: Corporate profits in the US (in billions of dollars).
Source: Statista Research Department 2021



Second, the price theory is undermined by platform companies, such as Meta or Twitter, that can offer their primary product for free. Meta, for example, offers their messaging service, WhatsApp, at no charge. Under the conventional price theory framework, Meta's business practices do no harm to consumers so long as they do not charge for their services. This, however, undermines the very framework underpinning Price Theory.

Price Theory is insufficient for the analysis of free products in two ways: the undermining of price mechanisms (Shampanier et al., 2007), data harvesting and privacy violation

(Cecere et al., 2007), and negative socioeconomic externalities (Gal and Rubinfeld, 2014). Price Theory contends that prices are used as an indicator of scarcity, signal of information, and an efficient allocation of resources. With the introduction of a free product, prices become distorted, negative externalities are created, and information is not properly conveyed.

Data harvesting and violations of privacy also compensate for "free" products offered by many tech giants. Often, the provision of free products is two-sided: users are allowed to access these sites at no charge because their data is collected while advertisers pay for their attention (Evans and Schmalensee 2007). Two-sided products can lead to violations of users' privacy, as data and advertising space are the firm's means to profit (Zuboff 2020). Under current frameworks of analysis used by regulators, issues such as data harvesting and privacy would not be a cause for concern to regulators, so long as Meta does not charge for their product (Gal and Rubinfeld, 2014). Having one side of these products appear as free increases the likelihood of data collection while also hampering price signals.

The introduction of free products undermines the price mechanism's ability to properly convey information. According to price theory, prices reveal information about scarcity and costs of production. In theory, higher prices should correlate to better quality goods. However, free products distort prices and halt the flow of information. This, in turn, leads consumers to pursue inferior goods that suit their needs while removing price as an effective tool of competition (Gal and Rubinfeld 2016, 9). For example, a tourism industry study by Nicolau and Seller (2011) compared demand for low-value and high-value hotels. The study found an offering of free breakfast at lower-value hotels led to an increase in demand above the value of the breakfast (Nicolau and Sellers 2011). Regarding tech products, a study conducted by Niemand et al. (2015) found that free digital goods led to consumers perceiving a higher value from inferior goods, forgoing the superior product that would have provided more utility. The provision of free products undermines price mechanisms, causing a distortion of the information disseminated to consumers. This, combined with network effects, amplifies any negative externalities created by free products, especially within the tech sector.

Finally, there is the issue with negative externalities. It has become well-documented within the tech sector that many free products have harmful effects. In order to maximize demand for advertising space, which is done to compensate for their "free" products, many platforms use algorithms to keep users entranced. This, however, can have harmful effects on users' mental health. For example, an internal study conducted by Instagram, which is owned by Meta, found that 32% of teen girls felt worse about themselves, many teens' suicidal thoughts traced back to said platforms, and 20% of teenagers felt worse about themselves after using Instagram (Wells et al. 2021). On top of these negative externalities, the ability for the firm to pursue both horizontal and vertical mergers erodes competition.

Meta's pursuit of both horizontal and vertical acquisitions has tremendous market and social implications. Meta, as well as other technology corporations, has an extensive history of predatory mergers and acquisitions that alter internal and external market conditions in its favor in order to deter or prevent new entrants to the market (Semmler et al. 2022, 179-190). While Meta may not be the only tech firm buying data analytics companies, it is the amount of acquisitions with competitive advantages that increased its market power.

With over 90 acquisitions, Meta has eliminated many of its rivals (Grullon et al. 2019). Competition from small firms prevents market leaders from decreasing the quality of product or stemming investment. Meta has even pursued data collection and analysis companies to gain valuable information that gives it an advantage over its competitors. This continuous acquisition campaign not only cements Meta's dominance over its current rivals, but also makes it harder for future ones to successfully launch and grow. This is a perfect example of the monopoly power granted under a price theory framework of consumer welfare.

Another concern raised by the Friedman Doctrine pertains to the balance of power between executives and other stakeholders. An increasingly common view today suggests that if corporations begin to function in an inclusive manner in regards to the decision-making process, then wealth will be diffused more broadly, and will cease to be concentrated in the hands of the few. Without broad-based union membership, workers have less bargaining power to ensure employment stability or pay equity.

For example, executive pay has skyrocketed in recent years as union membership has declined. In 2020, the CEO-to-average-worker pay was 351:1 under a realized measure of compensation (Mishel and Kandra 2021). In 1965 and 1989, it was 21:1 and 61:1, respectively, as illustrated in Figure 3 (Mishel and Kandra 2021). A raise in worker pay would be much deserved since productivity has grown 61.7% while average-worker wage growth has only been 23.1% (Moore and Banerjee 2021). A better distribution of power amongst employees and employers would help reduce these ratios and give workers more say in the decision-making process.

Figure 3: CEO-to-typical-worker compensation ratio 1965-2020
Source: Mishel and Kandra 2021

Year	CEO-to-typical-worker compensation ratio
1965	21:1
1978	31:1
1989	61:1
1996	117:1
2019	307:1
2020	351:1

This narrow view of a firm as a nexus of contracts gives an impression of financial breadth, but fails to consider the social ramifications of a firm's operations. The social nature of the firm, and its vital function in creating a healthy economy, should urge our business leaders to act in the best interests of society.

And then there is also the problem of competition. According to Friedman, "[t]he participant in a competitive market has no appreciable power to alter terms of exchange; he is hardly visible as a separate entity; hence it is hard to argue that he has any 'social responsibility'" (Friedman 2020, 120). According to this view, corporate power cannot grow, and companies' influence remains within the business world. This means that they have no direct social impact, and therefore should focus only on profit. While this may sound compelling, it has created an image of business as an entity that has no political influence.

It would seem that the main flaw in Friedman's approach is that it assumes market dynamics are an end-point for analysis, as opposed to a starting point. Current market tendencies have led to increased concentration in almost every sector (Gutiérrez and Philippon 2017). While mom-and-pop stores operate under perfect competition, nationally, industries are often dominated by oligopolies. Large corporations that employ hundreds of thousands of people and operate across the world are not obliged to abide by the conditions of perfect competition (Grullon et al. 2019). Most firms function in an oligopolistic market, and profit is based on the amount produced and variable costs. This further insulates them from competition while reducing overall investment (Gutiérrez and Philippon 2017, 13).

Under the Friedman Doctrine, firms do not make rules and are supposed to stimulate and uphold competition by operating with "open and free competition without deception or fraud" (Friedman 1970). However, there are numerous examples of corporations not only lobbying governments, but also writing the very laws themselves (Pappin 2020), producing an uneven playing field for those excluded from the process. Without fair and open interaction, large corporations are bound to take advantage of smaller firms and eventually change market conditions in their favor.

Another example is how ride-sharing companies, such as Uber or Lyft, take advantage of independent contract workers (Ley and Hu 2023; Scheiber 2017). Freelancers are not considered full-time employees by their employer but, instead, are seen as temporary hires for as long as both parties agree. Contractors have added an element of dynamism to the global economy but they have also created additional vulnerabilities. Because these workers are not considered full-time, they become a precarious work force that does not receive the full benefits of regular employees. The most important benefits—healthcare, retirement plans, and paid leave—are typically denied to independent contractors, who often take these jobs as a way to make ends meet. The ride-sharing firms have profited off these contractors, so much so that they spent $200 million to fight a California proposition that would classify their drivers as workers instead of contractors (Eidelson 2021). This is a stark example of how corporations act as rule-makers with socioeconomic ramifications. However, once firms embrace their role within society, they can begin to recognize the good they produce and can then identify how to do better.

The overall problem with shareholder capitalism is that one interest dominates another, as opposed to stakeholder capitalism's orientation towards a wider and more equitable distribution of power and benefits across various social, policy, and business stakeholders. The goal of stakeholder business models is not unanimous consensus but rather representation and input from every stakeholder involved in operations, as opposed to decision- and policy-making by a board made up of executives and shareholders. When the interests of one group are prioritized over those of another, the value created is shared narrowly and distributed inequitably (Freeman et al. 2007). The role of competition is not to be used as a means of social Darwinism, but instead should be complemented by fostering cooperation in order to create sustainable and mutually beneficial business ties between all stakeholders.

The idea of the firm as a nexus of contractual obligations to shareholders obfuscates for the business community any real sense of accountability for their actions. It also leaves out ethical considerations for the corporation's function within society as a whole. The transition to a multi-purpose-driven corporate model may better recognize the social function the firm plays within society.

Recognizing the social function of corporations creates an imperative for a more ethical means of doing business. As awareness of businesses' relevance in society grows, it is important for ethics to play a greater role in the decision-making process.

IV. Alternative Purposes for the Firm

There is a quite tangible distinction between a conventional for-profit corporation and what we refer to here as a multi-purpose-driven corporation. To understand the socioeconomic complexity of the latter, we must start by identifying the functions a firm performs within society. There is one main purpose a firm serves: investing in people and infrastructure in order to maintain sustainable prosperity.

One aspect of sustainable prosperity—more evenly distributed incomes— was common during the 1940s to 1980s in the United States (World Inequality Database 2023). However, shortly after the rise of Friedman and his colleagues from Chicago, a trend towards increasingly unequal distribution set in. This can be seen in the gini-coefficient, which is now at its highest point in the United States since records began (St. Louis Federal Reserve 2022). By contrast, we believe a firm is much more than just a short-term profit-maximizing business. It has societal obligations to retain most of its profits for reinvestment into productive capacities, which includes its employees. Once this is achieved, a virtuous circle of economic growth will become more self-fulfilling and more robustly widespread, also known as "sustainable prosperity" (Lazonick 2022).

A firm does not operate within a vacuum. It is a part of an intertwined investment triad—households, governments, and businesses—that allows societies to develop (Lazonick 2022). If one part of the triad begins to falter, the rest suffer. Households invest in education, making the people under their roof employable and useful to future businesses; governments invest in the healthcare and infrastructure needed to sustain communities, such as hospitals, utilities, and transportation, in order to maintain both households and businesses; and businesses use the people and infrastructure from the first two as a basis to invest in future productive capacities, such as new factories, job training, or tools.

If a firm does not use its profits to invest in beneficial capabilities, such as tools and human capital, then innovation begins to lag, and creative destruction is prevented. A firm's investment beneficiaries—employees and capital—help create the products and services their employers sell to generate the profits needed to stay afloat. When profit maximization is the only goal, a firm will experience mission creep and tend to use profits unproductively. For example, when an employer improves an employee's productive capacity through on-the-job training, licensing, or other formal training, their new production capacity becomes a fixed-cost asset that can help improve products and services by lowering unit costs. This, in turn, drives growth (Lazonick 2022). If executives and board rooms cut funding for job training, they will hamper collective learning, making the business become less efficient and innovative.

V. Success within a Purpose-driven Business

While a purpose-driven approach has not been fully embraced by all firms, its merits have proven worthwhile for the firms that have incorporated it into their operations and governance structures. Corporations big and small, domestic and international, and across various industries, have encouraged this transition and are looking for ways to implement it on a larger scale. For example, Gravity Payments, a credit card transaction firm, received recognition when their CEO, Dan Price, announced he would take a steep pay cut. The employees at Gravity Payments, based in Seattle, were struggling to meet the cost of living. Price decided to decrease his salary by a million dollars in order to be able to increase Gravity's minimum salary to $70,000 a year (Bryan and Wong 2017). Early indicators pointed to very positive results within the month. Within a month, Gravity received 335 new accounts and increased monthly recurring revenue, an important indicator for pay merchants. to $54,000 from the previous year's highest monthly total of $19,826 (Weiss et al. 2015). Within 7 months, Gravity had increased its revenues by 27%, hired 20 more employees, and increased employee satisfaction by 20% (Weiss et al. 2015).

Successful outcomes from implementing stakeholder and purpose-driven models have been seen throughout Europe as well. The famous Mondragon Cooperative Corporation has proven a success over time in a variety of industries, and has risen to become the seventh largest Spanish company in terms of asset turnover. Mondragon, a firm based in the Basque region of Spain, was founded in 1956 and has continued to grow ever since. It began as a manufacturer but has since grown by diversifying into the financial, retail, and education sectors/industries. Mondragon is well-known for its governance structure, which puts egalitarianism at the forefront of its structuring principles. Employees have a greater say in decision-making, and salaries are determined through a meritocratic approach.

The basis of Mondragon's success lies in its employee ownership. Each employee is a partial owner of the firm and has a base salary of $32,000 (Lovato 2020). Each employee has the right to participate in decision-making. Changes are voted upon by each division and require majority support (Forcadell 2005). While this may seem painstaking, it has delivered lucrative results.

Irizar, a coach and bus manufacturer and subsidiary of Mondragon, has a long track record of growth. Its success is due to the governance structure adopted from Mondragon (Casadesus-Masanell 2006). From 1991 to 1999, sales grew by 805% from €18 million to €163 million, and in 2003, reached €305 million (Forcadell 2005). Productivity grew at a similar rate of 18.4% in a seven-year period from 1993 to 2000, and the number of buses produced increased from 1.2 buses per day in 1991 to six buses per day in 2005 (Forcadell 2005). No matter what the indicator is, Mondragon and its subsidiaries have a proven track record of success.

Another successful model, in terms of work environment and fair compensation, of stakeholder capitalism that has been implemented on a larger scale is the German system of codetermination. The codetermination system involves a two-tiered representation of the most important stakeholders within a company in the corporate decision-making process. First, the labor unions in a corporation organize what is called a workers' council ("Betriebsrat"). The councils include the representatives of labor in the firm and deal with work conditions, work safety, and equal pay for the same jobs (Sandrock 2015). Second, there are stakeholders' representatives, including employees, at the company's board in proportion to the size of the corporation.

The codetermination system of Germany allows for greater employee involvement in decision-making and provides institutional infrastructure for the workers' voices to be heard. This, in turn, creates more cohesion between management and employees, decreasing the total number of employee strikes (Backes-Gellner et al. 1997). The management style of codetermination has supported the robust growth of the German economy for decades and has helped overcome some of the difficult aspects of recession or crisis pressures.

By contrast, the boards of large US companies usually operate behind closed doors and offer little information to non-board members during the decision-making process. Under the codetermination system, information is also disseminated to the employees and the public, substantially improving the corporate decision-making process via a two-way feedback loop between stakeholders and management.

There is also evidence to suggest that a more ethical supply chain leads to higher long-run profitability and return on investment. A JUST Capital survey of 928 American publicly traded companies showed that firms that actively perform and disclose Human Rights Due Diligence (HRDD) have, on average, a 3.2% greater return on investment than firms that do not (Mahoney and Patni 2021). For both the firm and the investor, it is a win-win.

These are some aspects of a purpose-driven company that, in fact, can provide less volatile and more robust economic growth for the firm, employees, and communities. Some critics believe that this model is impossible to implement across the economy. But, as one begins to examine firms that embrace a purpose-driven approach, one can see how it works for all types of firms.

The two of the Mondragon Cooperative Corporation and Gravity Payments are perfect examples of how a purpose-driven approach to doing business can be implemented in any firm. Mondragon and Gravity Payments are at opposite ends of the corporate scale: the former is a large multinational manufacturer with thousands of employees, while the latter is a small technology company with fewer than two hundred employees. If both of these firms, with their glaringly obvious differences, can implement purpose-driven approaches and achieve success, then it is likely that any firm can do the same.

In JUST Capital's company rankings, tech companies are usually at the top. This is because of their above-market compensation and benefits packages. One could assume from this that they do not require any changes to their operations. However, if one looks at the governance structures behind these tech firms, it is clear that further changes are still necessary. More transparency regarding the members of this group, their criteria for judgment, and their qualifications would not only help the public understand the decisions that Meta, for example, makes, but also help Meta make better decisions. Meta clearly offers their employees great benefits, but still has much work to do on the governance side.

Other industries have embraced an ESG and stakeholder paradigm shift as well. For example, Ford, a car manufacturer, ranks 20th overall in JUST Capital's top ranking companies. The competitive salaries and benefits packages come, in part, from unions. While competitive salaries and benefits packages at Ford are partly attributed to unions, the absence of environmental considerations integrated into the manufacturing process hinders their ability to attain a higher ranking.

Regardless of their profiles, all businesses and industries are capable of implementing a purpose-driven approach to conducting business. The challenge is, however, to evaluate in more comprehensive terms such new forms of capitalism.

VI. Implementers and Monitors of the New Paradigm Shift

While the potential of stakeholder capitalism and purpose-driven firms has only just begun to be realized, the corporations currently operating under a stakeholder model have already seen its value. The creation of purpose-driven corporations and the implementation of organizational purpose by existing companies is underway, but the purpose-driven model has not yet attained widespread adoption. Organizations, such as the Business Roundtable (see below, and Bebchuk and Tallarita 2021, 53), that promote the implementation of organizational purpose have gained influence, but some have yet to live up to expectations. There are two types of organizations to focus on when considering the mechanisms impacting this paradigm shift: implementers and ratings agencies. The implementers focus on integrating a purpose-oriented framework into the economy by providing stakeholder analytics, operations consultations, and advocacy. These entities guide larger firms in making the changes necessary for moving away from the profit maximization model. Rating agencies, on the other hand, track relevant indicators for each company and industry. These entities help ensure firms are meeting their goals and provide the transparency needed for informed public debate.

In the US, the most prominent implementer of stakeholder capitalism is the Business Roundtable (BR). BR is a business lobbying group that represents executives from the leading businesses across the country. Recent agreements by BR signatories to uphold stakeholder primacy represent an important step toward the establishment of purpose-driven corporations. But while they have made some lofty promises, they have yet to make much headway (Temple-West 2020).

Another implementer is the World Economic Forum (WEF), a non-governmental organization. It helps foster public-private cooperation and provides resources to help firms with their transition to a stakeholder model. The WEF has helped far more firms in this shift, and therefore is more influential than the Business Roundtable.

The United Nations plays a role through its Business Council, which promotes the Sustainable Development Goals and calls for a more ethical way of doing business as a means of economic development. While the Business Council does have some international traction, it will need much more influence domestically in order for its agenda to gain momentum within this paradigm shift. There is also the Project for Inclusive Capitalism, which has teamed up with the Vatican to promote and integrate stakeholder ideas into market-based approaches.

While the contributions of the implementers are quite useful, it is the ratings agencies and the public at large who are the most important in promoting and guiding (because they don't implement) a purpose-driven approach to business. All ratings agencies operate within the private sector and hold no regulatory power. Indeed, regulators often rely on data from these institutions to enforce the law.

One of the most useful corporate rankings can be found in the Sustainability Accounting Standards Board (SASB). The SASB has a set of metrics for each subcategory of industry that can be used to measure a firm's sustainability. Another ratings agency is called JUST Capital, which ranks firms based on self-reported criteria. It identifies stakeholder issues via public polling and helps to assess how each company approaches them. Data from JUST Capital, however, presents some difficulties, as the data is self-reported. There is also the World Benchmarking Alliance, an organization created to help the private sector achieve the Sustainable Development Goals, and its Corporate Human Rights Benchmark, which ranks corporations based on an ethical value chain. They base their criteria on six different factors, including transparency, remedies and grievance mechanisms, and policy commitments. Finally, there is the Mercer Global Pension Index, which gives investors a glimpse of how sustainable and socially beneficial their investments are, but is not necessarily stakeholder-focused.

Each of these ratings agencies has its own positive features and varies in its use of qualitative or quantitative analysis (Table 4). The most comprehensive ratings are carried out by the SASB, as it gives specific qualitative metrics for each industry and company. The metrics involve no estimations or subjective interpretations, as SASB takes information from corporate financial documents and translates them into sustainability data. JUST Capital offers a similar service, but uses biased data from firms, as opposed to financial documents. This means that some of their findings, while useful in determining the direction of progress, are not fully and objectively informative. It is important to measure factors such as employee satisfaction, but the information is more valuable from an unbiased third-party survey. Of course, firms would like to empirically show employee satisfaction, but the data should be objective. The Mercer Global Pensions Index is useful as it gives some information about sustainability in relation to individual investments, but it fails to provide any data about human rights due diligence or any examination of non-tangible assets.

Figure 4: Benefits of each ratings agency

Name of Firm	Qualitative	Quantitative
JUST Capital		X
SASB	X	
World Benchmarking Alliance		X
Mercer Global Pension Index		X

We believe more influence should be given to the ratings agencies that help monitor these corporations. Ratings agencies help verify each company's success in their socio-economic goals, and help keep the public and regulators informed. They should work in tandem with regulators in helping to understand and quantify this new form of capitalism. While they should not have legal standing, they should be listened to by the academic, business, and regulatory community. While implementers deserve some credit, they have yet to achieve all their objectives. BR especially has yet to fulfill many of its lofty promises. In some cases, individual CEOs within the organizations work against the very goals BR promotes. If BR wants more influence within the same circles as ratings agencies monitor, then they must fulfill their own promises.

VII. Institutionalization of Proper Governance

If one thinks about stakeholder capitalism and purpose-driven corporations, improvements should happen on two fronts: both the private and the public sector. Despite the business community's desire to implement the changes relevant to their industries, businesses in both sectors are slow to adapt and will need some type of guiding framework. The challenge is to develop universal guidance that is consistent for locally, nationally, and internationally operating businesses.

The previous regulatory philosophies are still embedded within governing bodies and it will take time to adapt to new ways of thinking. Regulatory agencies and public officials should help accommodate firms into this paradigm shift with patience and should avoid rapid large-scale shifts in a commanding manner. If these reforms are to be institutionalized, this should be undertaken with both a top-down and bottom-up approach. Lastly, an extensive body of laws and responsibilities does not need to be entirely reconceived but may, with appropriate adaptations, serve as a foundation on which to build a more sound, flexible, and crisis-resistant regulatory framework.

VIII. Government and Regulatory Requirements

The current corporate regulatory standards do not suit purpose-driven businesses, and will therefore require new or modified standards as new methods to monitor and regulate them to ensure firms do not harm their stakeholders. The SEC has recently issued standards for climate-related disclosure requirements, a promising advancement for the monitoring of ESG goals. But, the social and governance pillars of ESG, and to what extent ESG is institutionalized, are less monitored due to the difficulty in quantification. Moreover, many of the reporting requirements that identify a firm as ESG-driven are voluntary, and not compulsory. As scrutiny around ESG grows it is imperative to enact high quality standards and reporting mechanisms while avoiding political overlap.

Also, as collective bargaining begins to make a possible resurgence, it may be up to governments to reform protective labor market practices in order to complement the stakeholder transition. Workers should be able to have representation within board rooms, regardless of union membership, when it comes to decision-making (Strine 2020). This is key to the success of Mondragon and the companies that implement codetermination: empowering workers to voice their claims for higher wages and better working conditions.

Another means of improving stakeholder integration is to allow corporations to become public benefit corporations via majority vote (such as 60/40), as opposed to the supermajority needed now (Strine 2020). A public benefit corporation is a company that operates in a responsible and sustainable manner in order to enhance public good (Wex Definitions Team 2020). Well-known examples of successful public benefit corporations are Patagonia and Ben and Jerry's, as they are operating while being socially conscious.

Corporate bailouts could lead firms to establish themselves as public benefit corporations (Strine 2020, 13). These bailouts, while acknowledging the social role the firm plays in society, socialize risk at the expense of taxpayers (Strine 2020). If communities are to restore these firms in times of financial distress, it should be guaranteed that these firms will work in the communities' best interest. In the event that firms request wage concessions, the subsequent loss of wage income effectively extends an interest-free credit from workers to the firm. This credit should be repaid once the firm regains higher post-crisis returns on capital. Another way is employee ownership of capital belonging to the firm. In the U.S., during and after the pandemic meltdown, neither of these two compensation mechanisms seem to have been utilized.

In the US, the governance structure of most corporations today may change as well. Because of these changes, workers may see their decision-making power increase. By adopting workers' councils, similar to those in Mondragon or the German codetermination system, business can be conducted with a more democratic approach. This will also dilute the power of board members, who often hold large portions of shares within their company, including trusts and holding corporations for such companies, and will delegate more decision-making power towards stakeholders.

To enforce these new proposals, policy-makers should promote, and possibly require, greater transparency on issues such as total employee compensation, diversity, cost of benefits, training and education, environmental impact, executive compensation, and governance structure. Firms have stalled to adopt ESG disclosures and so some regulatory intervention can help speed up this process. On top of this, ESG has become much more controversial, which may further stall its implementation. This has created an inflection point for the concept, which may ultimately be abandoned by the business community.

Accounting standards may also need some fine-tuning by regulators as well as by the Financial Accounting Standards Board (FASB). For example, in order to better understand the long-term health of a company, and to have an informed discussion within the board, firms should treat expenditures in human capital as a long-term investment, as opposed to an immediate expense (Strine 2020). All such changes will require commitment and flexibility from all parties involved. Clear and pragmatic standards should be set by experienced regulators in order to adjust accounting practices to this stakeholder shift.

IX. Private Sector and Business Community Changes

Though a purpose-driven implementation is underway, there are four major private sector stumbling blocks to its success. First, a lack of standardization in stakeholder metrics and reporting hinders the quantitative analysis of new conduct. When a publicly traded firm has its financial documents examined and its credit evaluated, it has a limited number of auditors to choose from due to high levels of concentration in the industry and stringent regulation. It does not matter if firms use different agencies, so long as they are all measured in a uniform manner. If publicly traded companies were to go through a standardized process, and one that includes measures for sustainability, HRDD, and non-tangibles, investors and the public would have a better understanding of how these businesses operate in regard to ESG as well as their stated mission.

Second, there should be a greater emphasis on the ESG and stakeholder issues from a regulatory examination standpoint. As of right now, disclosing environmental and intangible impacts is largely voluntary for most firms. There is, however, pressure on both individual companies and the corporate world in general to provide these disclosures, but it will take time to make such disclosures mandatory. Until this happens, firms should take the lead and disclose as much information regarding these topics as possible. According to Ernst and Young, one of the Big Four accounting firms, 89% of companies are beginning to measure their environmental impact (Steinberg 2021), and 72% of investors, "[c]onduct a structural, methodical evaluation of non-financial disclosures" (Nelson 2020). Although this indicates a move in the right direction, as long as asymmetric information is produced, it will remain difficult for the public to identify businesses that act ethically.

Third, quantitative ratings agencies should stop relying on companies' self-reported data or at least develop more robust practices to cross-check and validate the data provided. While some data is better than no data at all, if employee surveys are to be effective, they should be unbiased and should be conducted through a third-party monitoring institution assuring anonymity. This ensures a healthy feedback loop between employees and management, which executives can use to better understand the needs of their workers.

Fourth, there is the issue of superficial ESG and stakeholder changes. When the Financial Times discussed the concept of ESG recently (Armstrong 2021), it was pointed out by practitioners and academics that it may have been the CEOs of large corporations who actually initiated discussions of ESG changes within their companies because they saw an opportunity to exploit ESG in their own interests (Fancy 2021). They seem to have seen a chance to diminish the role of shareholder activists and shift power back to the corporate boardroom and the CEOs without actually passing on decision-making power to the stakeholders. This is, in fact, a real danger if the issue of corporate governance is not simultaneously addressed.

Until now, waves of change have happened on a firm-by-firm basis. Empowering groups to solve the problems they know best allows for the most effective and comprehensive solutions. The individuals who experience these problems first-hand have the most knowledgeable solutions. Because of this, stakeholder capitalism should largely be implemented on a local level (Schwab and Vanham 2021). For a firm that operates across states, or even countries, this means giving the stakeholders within their respective sphere of influence a say in the decision-making process. A firm operating internationally should prioritize its domestic stakeholders, as they are the primary beneficiary of commercial growth. As more and more empowered communities begin to work in the same direction, the easier it will be to tackle the issues they face.

The purpose-driven corporation, with its social orientation, harnesses the economic might of communities and firms in order to work in the same direction. This aligns the best interests of individuals, communities, and corporations, ensuring the decisions made by each specific actor create sustainable prosperity for all.

X. Conclusion

The productive capacities unleashed by shareholder capitalism have created boom-bust cycles with asymmetric socioeconomic consequences, such as stagnant (and, in some cases, falling) living standards and poverty traps for large swaths of populations across the globe behind a facade of steady economic growth. Over a century since the U.S. Gilded Age, the global economy is again facing what Henry George calls the dilemma of "progress and poverty."

The new models of capitalism discussed in this paper aim for a broader diffusion of power within corporate governance by giving the stakeholders a more explicit and secured role in the decision-making process across business and policy initiatives, while also recognizing the firm's socioeconomic and environmental functions. This will ultimately allow for continuous innovation and create an incentive structure for sustainable prosperity, similar to the one experienced in the post-WWII period. The social and environmental responsibilities and the proper governance of the firm cannot be ignored. It requires a deeper understanding than the "nexus of contracts" view. While there is still much progress to be made on the part of the implementers and in the standardization of reporting, screening, monitoring, and enforcement by the public, the policy prescriptions offered in this paper provide some much needed direction for this paradigm shift in overcoming the dominance of the Friedman Doctrine.

A multi-purpose-driven corporation, a firm driven by both business success as well as social and public service, distributes value more equitably and reduces socioeconomic polarization. The shift to this corporate model by firms ranging from the local general store to colossal multinational corporations will empower local, national, and international constituencies. The opportunity for reform is here, but it will require creative energy and flexibility from all. In this context, everyone becomes a stakeholder.

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