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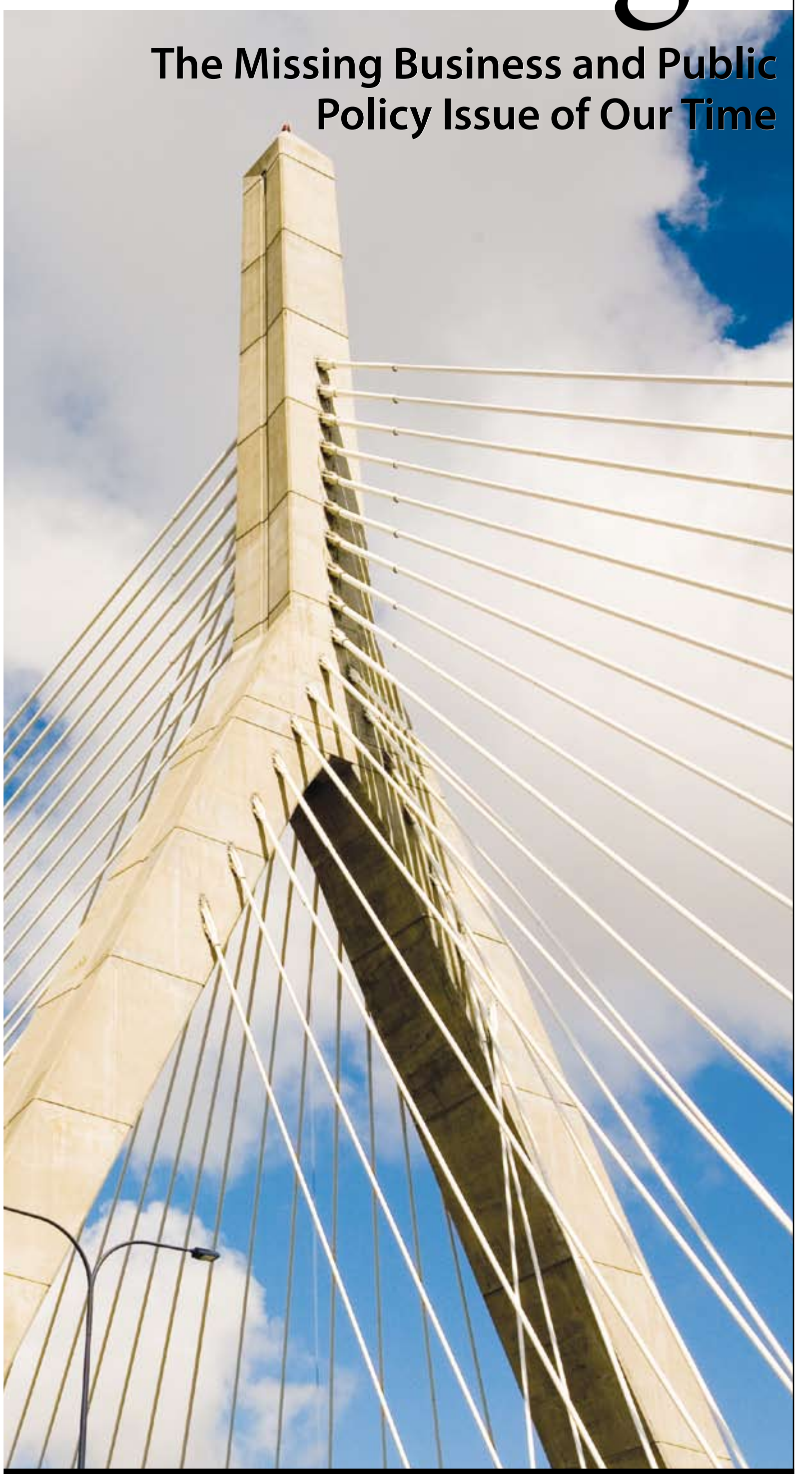
Corporate Design

The Missing Business and Public Policy Issue of Our Time



How can corporations be designed so as to blend social, environmental, and financial mission at their very core? This is the design challenge of the 21st century.

By Marjorie Kelly and Allen White

Corporation2020
Designing for Social Purpose

Business leaders operate today inside a corporate design largely inherited from the 19th century, with ownership and governing structures put in place during the horse and buggy era. In that time, when nature offered seemingly unlimited resources, we had not yet confronted the ecological limits we face today. In that era, when labor meant interchangeable strong backs wielding hammers and picks, employee knowledge and capacity to innovate did not yet represent the foundation of competitive advantage as it does today. In that time of hands-on ownership by company founders and direct investors, it was impossible to imagine today's environment of dispersed and passive share-holding, where trading may occur in nanoseconds.

Yet, while these essential elements inside and outside the corporation have changed dramatically, surprisingly little has changed in the design of corporate forms. The dominant ethos retains a focus on short-term benefit to "owners," regardless of how remote, passive, or transient they may be. Within this narrow purpose, we struggle to fit contemporary concerns.

Executives are forced to focus on cost-cutting, quarterly returns, and short-term quick fixes to boost revenues. Companies are drawn into mergers that benefit few, while short-term gains in share price give way to long-term losses for shareholders and layoffs for employees. Firms are unable to invest in environmental sustainability options that will pay off far down the line, instead feeling pressure to devote assets to buying back stock. There is an urgent need for corporate designs that free executives to focus on the long term, to recognize and reward the contributions of multiple stakeholders to corporate wealth creation, to protect companies from unwanted takeovers, to treat employee knowledge as an asset in financial statements, and to encourage rather than penalize critical research and development investments.

Consider how contemporary corporate design challenges play out today, in the cross-currents and competing demands faced by corporations:

▪ **A dominant front-page news story in** the summer of 2007 was the pending sale of Dow Jones and its flagship newspaper, the *Wall Street Journal,* to media baron Rupert Murdoch. For a century, the Bancroft family that controlled the *Journal* had put journalistic integrity first, insulating this mission from the short-term demands of market forces, while at the same time building the paper into a financial powerhouse. The family helped the company blend social mission with financial success. But as newspapers across the country struggled to adapt to the transformed news environment created by the Internet, a sale of the paper—particularly at the 67 percent price premium that Murdoch offered—began to seem the best option. This led the Bancrofts to a new challenge: a potential new owner who was known for intruding on editorial independence at other media properties such as the *New York Post* and Fox News. In the absence of voluntary, benevolent family oversight, could an oversight system be designed to project journalistic integrity? The question the Bancrofts faced was one of corporate design for social mission. How could a company design its governance structure to balance financial demands with a non-negotiable social purpose?

▪ **Companies such as Nike, Disney, and** New Balance have sought to put in place protections for workers at overseas factories manufacturing their products. These companies have created codes of conduct and fielded teams of social auditors to ensure compliance, yet factory working conditions still have fallen well short of company standards. At many factories, workers are subjected to demeaning criticism by contract factory managers, prevented from taking bathroom breaks, and denied the full value of wages earned. The problem is that these companies send mixed messages. On the one hand, their codes of conduct tell suppliers to run safe workplaces and pay fair wages. On the other hand, their purchasing managers tell suppliers to produce low-cost products and deliver them on highly demanding schedules. The result? Purchasing is the winner and workers the loser. Companies such as these with complex supply chains have not solved the corporate design issue at stake: How can social issue management move from the periphery to the core of company operations?

▪ **In still a different form, corporate design** issues have confronted BP, the British company that at one time enjoyed a largely unblemished global reputation as an environmentally conscious oil company, marketed as the "Beyond Petroleum" organization. That was before 15 people died in Texas City, Texas, and 180 were injured owing to an explosion at a BP refinery, after the company decided to reduce costs by skimping on maintenance. These were the allegations in a May 2007 investigation by the U.S. House of Representatives, which was also looking into two oil spills by BP at Alaska's Prudhoe Bay oil field in 2006. Those spills followed a decision by the company to cut the budget for maintenance and pipeline inspection. Damage to the fragile Alaskan environment may never be completely reversed. And damage to BP's image as a corporate responsibility leader among oil companies will take years to recover. The company has not resolved its central design challenge: how to structure internal decision-making to give priority to long-term environmental sustainability instead of short-term cost-cutting.

Editorial integrity under challenge in the sale of a newspaper, well-intentioned but ultimately ineffective factory auditing, under-funded maintenance at an oil company: these seemingly disparate situations are, in fact, linked by deeply rooted forces that shape the corporate practices in question. In all these situations there is a deep-seated yet invisible issue—a problem that has had no name, that remains absent from public discourse. That issue is corporate design.

A New Public Idea: Corporate Design

A moment of paradox and opportunity has arrived. How can corporations be designed so as to blend social, environmental, and financial mission at their very core? This is the design challenge of the 21st century.

Corporate design is the missing business and public policy issue of the day. It is connected to countless other major issues: the working poor, the shrinking middle class, wealth concentration, the ecological crisis. We can no longer deal with these issues as though they are separate and unrelated. We face today a historical moment when a fragmented, reactive approach to corporate responsibility must give way to a systemic and structural approach commensurate with the expanding economic, ecological, and social footprint of the modern corporation.

Bringing corporate design in line with 21st century expectations means bringing social mission from the periphery to the core of the organization. This requires both external and internal transformation. It entails conscious design of the architecture of law, charter, governance, internal incentives, and interface with capital markets. Ultimately, it's about whose interests a company is designed to serve, and whose interests are subordinated or disregarded.

Corporate design is about the purpose of the firm, and about the systems and structures that give life to that purpose. It's about the narrow purpose inherited from the 19th century, which is increasingly outmoded in light of 21st century societal expectations. It's about the obligations and responsibilities a company has to those affected by its activities. In a tangible sense, corporate design is about creating parity between social and financial considerations in terms of both external accountability and internal operation—in company mission, values, and governance.

Modern corporations are arguably the most powerful social institutions of our day. In many ways, they govern modern life. But the issue of corporate design has yet to find its place on the public agenda. Instead, debate focuses on single companies, single issues, single incidents. It is driven most often by crisis rather than by the intentional and inclusive process which major public policy issues warrant.

Most within and outside the business community assume, without explanation or comment, that profit-making and shareholder value are the core purpose of the corporation. We think of this core purpose as something akin to a natural law, such as gravity or thermodynamics. As such, profit-making and shareholder value are deemed beyond reproach. They are not to be subject to fundamental change, only modulated incrementally with piecemeal laws aimed at specific harms.

We rarely step back and look comprehensively at the way the design of the corporation gives rise to the behaviors that most consider anti-social or, worse, reprehensible. Corporate design influences behavior in ways we take for granted. We think of the relentless pressure to deliver rising earnings and unending growth as somehow intrinsic to the very notion of the corporation, not realizing that it is in large measure the outcome of a particular corporate design. Other designs are possible. They are not the implausible dreams of idealists. They are, in fact, already functioning at substantial and successful companies.

> Deeply rooted forces in corporate design contribute to countless major issues: the working poor, the shrinking middle class, wealth concentration, and the ecological crisis.

Corporations have unparalleled capabilities to address urgent economic, environmental, and social challenges. Yet imagine for a moment what would happen if, say, a pharmaceutical corporation unilaterally shifted to a dual core focus on financial return and enhancement of public health. Let's say it announced it would sell life-saving drugs at cost in developing nations, foregoing profits for a quarter of its revenue stream. The reaction of the markets would be predictable: downgrading by stock analysts, declining share price, and vulnerability to takeover by outsiders committed to returning the firm to its "real purpose." Under the rules currently governing corporate designs, this hypothetical experiment in social purpose would be short lived.

In important ways, corporate design is not only about legal and technical issues but also about the cultural environment in which corporations operate. It's about what everyone knows to be true, and what everyone knows is impossible. The question "what are companies for?" is rarely raised and rarely debated. Yet without this debate, it is difficult to imagine how the vital institution of the corporation can optimally address the critical needs it is uniquely capable of meeting.

The question of corporate purpose and design should no longer be left to the judiciary, as it has been since the 1800s, with courts defining corporate rights but leaving corporate responsibilities undefined. The courts are by their nature conservative institutions, because their purpose is to interpret laws and judicial precedents established in the past. The matter of crafting future governing institutions properly belongs to public opinion, public policy, and ultimately the people's representatives in the halls of government.

In a historical context, corporate design has never been subject to the kind of process essential to building any governing institution—the kind of process by which constitutions have been written and governing frameworks forged in democratic nations the world over, during the last three centuries. Such processes—whether in the U.S., European Union, Japan, or South Africa—share certain commonalities. Most prominent among them are two: first, a foundation of shared principles built through a political process, sometimes peacefully, sometimes through strife; and second, an array of operating elements that translate these principles into institutional designs that give them life.

With the ascendance of corporations to the highest levels of power and influence, principles and elements must be developed for corporations though a public process. It is remarkable that such a process has not occurred. We today face a moment in history to correct this gaping hole in national and global governance.

Growing Unease

We can't solve the problem of corporate design using past approaches to corporate reform. We can't solve it by listing every possible harm a corporation might create or every positive contribution it might make and then writing laws to prohibit or mandate specific actions. Further, we can't solve it by having corporations devote 1 percent of their profits to philanthropy, or by incentivizing adoption of piecemeal corporate social responsibility initiatives. Indeed, the inadequacy of such incremental approaches is what makes necessary the deeper, transformational approach of corporate design. Without frontally addressing the purpose of the corporation, the coming decades will default to business as usual, leading to an unacceptable future for people, the planet, and corporations themselves.

To date, mechanisms to hold corporations accountable to broader societal in-

Civil Society Design Tool: The Circuit Breaker

One possible design tool is the circuit breaker, which can break into the profit-maximizing feedback loop, giving power to communities and labor. A circuit breaker opportunity arises any time a company needs government permission, as in permission to merge or to acquire a land-use permit.

A valuable precedent is the Community Reinvestment Act (CRA), which requires banks to have good community-lending ratings in order to attain merger approval. A denial issued once—as happened with CRA—made the industry take note. The citizens' group ACORN has used the CRA to negotiate over $1 billion in lending agreements for low-income neighborhoods in cities such as New York, Minneapolis, Chicago, Boston, St. Louis, and Des Moines.

Another powerful example is the work of the Los Angeles Alliance for a New Economy (LAANE), which uses Community Benefit Agreements to give community and labor groups a voice in shaping publicly subsidized development projects. In exchange for providing community benefits—quality jobs, training, affordable housing, green building practices, parks, and child-care centers—developers get community support for projects. Without this support, they may find building permits or environmental impact statements rejected, since these often require public input processes. This model is spreading across the nation, from Seattle to Boston, thanks to coordination by the Partnership for Working Families, which provides a network for regional organizations to share best practices.

Another potential circuit breaker can be found in government procurement and investment policies, though this power is currently diffused in small, piecemeal, uncoordinated efforts. For example, 47 states have purchasing preference laws for recycled goods; 19 states have soy, alternative fuel, and energy-efficiency preferences; and at least a half-dozen states have buy-local preferences.[6] If governments used their purchasing and investing power in a systematic way—to reward responsible companies and shun irresponsible companies—it could become a powerful new system design element.

terests have had limited impact because they address symptoms rather than root causes.[1] This absence of accountability has led to a widespread, if largely unnamed, uneasiness about corporations. In most countries, corporations are accountable to shareholder interests, but even this group has powers limited to election of directors and the right to sue the corporation for breach of fiduciary duty. These powers too often are hypothetical, or carry high costs of implementation. The result is that decisions with far-reaching effects on employees, communities, and the environment occur with no public input, and virtually no oversight even by shareholders. The endless quest for short-term earnings—heedless of long-term social costs—is virtually on autopilot.

If lack of accountability is one key area of concern, another is company transience. The relentless search for low-cost production locales and the breathless pace of mergers and acquisitions both occur in a detached way—detached from any rootedness in community or loyalty to nation.

A third key area of concern is the wealth disparities corporations create. Executives enjoy outsized pay packages while employees struggle to make ends meet as real wages stagnate. Such disparities—accepted by many as the consequence of market forces—are the natural outcome of a system based on power imbalance between those who hold organizational decision-making power and those who contribute to long-term wealth creation; namely, employees.

The social costs of disparities, transience, and lack of accountability feed the call for corporate transformation.

Understanding the System Design

The corporate system is analogous to an organism that has lost its capacity to self-regulate. Living systems—organically interrelated with the larger living system around them—have feedback loops that modulate growth. Yet, in the corporation, all feedback systems seek the same relentless ends: faster growth, limitless scale, and greater short-term profits.

Seeking maximum short-term growth in earnings is the source of enormous pressure on executives. It starts with securities analysts, says Bill George, former CEO of Medtronic, now at the Harvard Business School: "It starts with the analyst's call, asking, 'Are you going to make the numbers? We've got you down for 34 cents [earnings per share]—you going to make it?' You ask yourself, do you want to go on CNBC and be made fun of because you only made 32 cents?" he continues. If earnings are up but fall a bit short of projections, the stock can go down precipitously, leaving the company vulnerable to a takeover.

Stock analysts are one of three components in what former Citigroup CEO John Reed calls the "iron triangle of short-term pressures." The other elements are stock options and hedge funds. Facing pressures from these sources, executives too often turn to questionable earnings management. As John Graham of Duke University and others showed in a 2004 analysis, three-quarters of executives say they would at times artificially smooth out earnings, rather than pursue real economic value, because of pressure for performance.[2] Executives can then put pressure on subordinates by setting overly aggressive targets. One recent survey found that pressure to meet unrealistic business objectives was the prime cause of unethical behavior—cited in seven out of ten instances.[3]

Inside the company, these pressures lead to layoffs, outsourcing abroad, cutting health benefits and pensions, and stagnant wages. Outside the company, the pressures can ripple through the economic chain—leaving customers to face pressurized sales tactics, creating pressure on families to take on more debt than is healthy, and increasing pressure on the already fragile ecosystem.

Like any healthy natural system, future corporate designs need feedback loops that signal imbalances. They need mechanisms that deliver input from all legitimate stakeholders of the corporation, so that financial interests are reconciled with the interests of employees, the community, and the environment.

> To date, mechanisms to hold corporations accountable to broader societal interests have had limited impact because they have addressed symptoms rather than root causes.

The signals that drive corporate behavior depend on the essential operating elements of corporate design. These include the purpose of the corporation as expressed in law and tradition; ownership structure; governance structures that define power and accountabilities; and internal incentive systems. As currently constituted, these signals overwhelmingly point toward maximization of profit and share price.

All those connected to corporations are caught in corporations' inadvertent design—investors and executives as much as employees and citizens. But this can change. Corporations can escape the vice grip of short-term pressures. Intentional designs can build equitable and responsive organizations, committed to the needs of long-term investors, employees, the community, and the planet. These are the companies that will prosper over the long run.

The way forward is to rethink the role of the corporation in society and redesign its architecture—at the level of both company and government oversight—so that speculative, short-term pressures are reduced, and responsiveness to social and environmental concerns are enhanced.

New corporate architecture can help investors escape the bone-rattling roller coaster of stock market volatility. Ratcheting down the speed of speculation can help investors lower their risk and enjoy more reliable long-term returns. Reducing capital pressure goes hand in hand with enhancing environmental and social performance, directing corporate decision-making in ways that avoid growth at any cost and abuse of ecological and human resources. A new corporate architecture can bring working people relief from the pressure cooker of the modern workplace, where there's little time for leisure and family life. Corporate design can be a key pivot point moving society toward sustainability and broader human well-being.

Finding Precedents

As we move forward in building new corporate architecture, we face a multitude of choices. Design principles are needed. We can find comparable design principles in the U.S. Bill of Rights, the proposed European Union constitution, and the United Nations Universal Declaration of Human Rights. These are examples of foundational principles that articulate the responsibilities governments have to the public.

The ascendance of corporations as entities equal in power to many sovereign governments calls for a similar articulation of corporate obligations to society. Precedents exist for such statements, though none exactly pertain to corporate design. The UN Global Compact provides a ten-point platform describing norms for business conduct in relation to human, labor, and environmental rights, and to anti-corruption practices. The OECD Guidelines for Multinational Enterprises and the Principles of Corporate Governance similarly set forth behavioral norms. At the national level one can look to statements such as the King Commission on Corporate Governance in South Africa.

In the spirit of these precedents, the principles offered here have been developed by the Corporation 20/20 initiative, a three-year, multi-stakeholder process involving some 200 people from business, finance, government, labor, law, and civil society.[4]

New Principles of Corporate Design

1. The purpose of the corporation is to harness private interests to serve the public interest.
2. Corporations shall accrue fair returns for shareholders, but not at the expense of the legitimate interests of other stakeholders.
3. Corporations shall operate sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs.
4. Corporations shall distribute their wealth equitably among those who contribute to wealth creation.
5. Corporations shall be governed in a manner that is participatory, transparent, ethical, and accountable.
6. Corporations shall not infringe on the right of natural persons to govern themselves, nor infringe on other universal human rights.

New Principles of Corporate Design

The New Principles of Corporate Design are intended as a compass for all players with a role in shaping the architecture of future corporations, including business, governments, and civil society. Consider illustrative implications for each of these sectors.

PRINCIPLE 1, PURPOSE:
The purpose of the corporation is to harness private interests to serve the public interest.

Corporate design starts with purpose. Why does society allow corporations to exist? To serve the public good. Why do individuals start corporations? To serve their own interests. Effective design knits these two together. Principle One articulates an emerging social consensus: corporations have social responsibilities, and when those conflict with profit-making, the public good comes first.

PRINCIPLE 2, CAPITAL: Corporations shall accrue fair returns for shareholders, but not at the expense of the legitimate interests of other stakeholders.

Capital deserves a fair return, with one critical caveat: it shall not be achieved by externalizing costs onto other legitimate stakeholders such as employees, communities, the environment, and future generations. How can corporations attract capital without handing control of the organization to capital, thereby inducing such externalization? The answer lies in rethinking the corporate-capital interface. One lever, for example, might be slowing down short-termism by requiring investors to hold shares for a year before gaining voting rights, or enacting strong capital gains taxes on short-term trades. Similarly, compensation incentives might be changed to modify or even outlaw stock options, or make bonuses contingent on achieving social and environmental performance targets. Another lever might be new kinds of stock exchanges or new forms of corporations that rebalance capital control in innovative ways, through dual-class voting or creating holding companies with designed-in social mission.

PRINCIPLE 3, SUSTAINABILITY:
Corporations shall operate sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs.

Society expects organizations to take the long view, which is the essence of sustainability. The role of government is to set broad environmental policy—such as carbon limits—and the role of business is to adapt in flexible ways. Sustainability should also be embedded in the corporation's governance structure, for example, through board-level training in sustainability concepts, creation of sustainability committees, or setting environmental performance targets for the CEO. Boards might designate a seat for an environmental expert, or government could require this for sectors with heavy ecological footprints such as mining and forestry. Companies should be required to produce annual sustainability reports, as several thousand already do voluntarily. Sustainability ratings for companies might also be used as a benchmark for awarding government contracts.

PRINCIPLE 4, WEALTH: Corporations shall distribute their wealth equitably among those who contribute to wealth creation.
Wealth should flow to those who create it. That implies an equitable distribution among the parties who jointly and inseparably contribute to the wealth-creation process. Boards might conduct an annual review of the sources of company wealth—for example, weighing the relative contributions of capital and labor, and the successes of various departments—and make profit distributions accordingly. Government could make widespread employee ownership a goal on par with the post-WWII goal of widespread home ownership, perhaps via a government-chartered financing vehicle similar to Fannie Mae, which was chartered by the federal government to create mortgage financing. Employee profit-sharing should also become routine, perhaps mandatory. And all of this should be undergirded with a society-wide commitment to a living wage.

PRINCIPLE 5, GOVERNANCE: Corporations shall be governed in a manner that is participatory, transparent, ethical, and accountable.
Governance is a central lever by which purpose is operationalized by the firm. And governance is about who holds the levers of power: who owns the company, who gets to vote, who's on the board, and what the board focuses on. It's about articulating a vision of company success that includes but goes beyond financial measures. And it's about tracking progress toward that vision with measurement and reporting, pay incentives, and mission review.

PRINCIPLE 6, POLITY: Corporations shall not infringe on the right of natural persons to govern themselves, nor infringe on other universal human rights.
Internally, corporations must recognize that the rights of corporations are constrained by a higher social imperative, that government is the ultimate arbiter of the public interest. One matter is unequivocal: government is accountable to the people, not to corporations. That means creating transparency for and strict limits on lobbying and campaign contributions. Companies must also recognize that human rights take precedence over company rights, and that human dignity must not be compromised for profit. This might mean companies embrace a compact describing their human rights obligations, as has been under discussion for five years at the UN.

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The Way Forward

In the end, implementing these principles is not exclusively dependent on the internal initiative of corporations, external mandates from government, or external pressures from civil society. We need a combination of the three. Instead of the polarizing lens of mandatory versus voluntary initiatives, we might think of a pathway that can be called "facilitated internalization." In this model of change, guidance and oversight is provided by government, flexible compliance is undertaken by corporations, and pressure and vigilance is provided by civil society. For example, government might direct investing and purchasing dollars toward responsible companies and avoid doing business with irresponsible companies, using a social rating system developed with civil society. There might also be oversight through a chartering and charter renewal process, open to civil society input.

The principles aim to redress the imbalance that has evolved over nearly two centuries of legal decisions and corporate practices, which together have expanded the rights of corporations without a commensurate expansion of their obligations. The challenge is to rebalance rights and obligations, to release the capacity of the corporation to create wealth, and to contribute more broadly to human well-being.

The resistance to such changes should not be underestimated. Parties with a vested interest in the status quo will undoubtedly oppose corporate redesign. From a broader societal perspective, however, there is no choice. As dominant institutions in society, corporations have societal obligations. Shaping future corporate forms to honor these obligations is the design imperative of the 21st century.

The Fourth Sector:

Case studies in corporate design for human well-being

One powerful alternative design is Organic Valley, a cooperative with revenues of $330 million, which is owned by 1,183 organic family farms and allows farmers to stay small while selling nationally.

Alternative company designs, which are created for the well-being of various stakeholders, from employees and producers to customers and society in general, are already operating at successful firms. The companies profiled here are designed from the inside out to position social value on a par with financial value, seeing profit as an enabler in service to a higher purpose

These companies represent the emergence of a promising new sector—a fourth sector, beyond the traditional three sectors of business, government, and nonprofits. Fourth sector firms in their fundamental design blend social and financial concerns. While the traditional design serves one dimension, finance, alternative designs serve different kinds of human well-being: livelihood, housing, retirement, healthy food, and a thriving culture.

The fourth sector encompasses a variety of alternative designs, including employee-owned companies such as the John Lewis Partnership; family-controlled mission-driven firms such as the New York Times; government-chartered companies such as Fannie Mae; nonprofit-owned companies; cooperatives such as Organic Valley; and emerging hybrids such as the Grameen Danone Foods Social Business Enterprise in Bangladesh (described below in the "Pathways Forward" section).

In profiles below, we see how the key operating elements of a firm can be designed in different ways. The initial system condition is a mental model, the pre-analytic vision of what a company is. This vision is embodied in social mission, which in fourth-sector firms is designed into culture and operational systems.

A key part of mission is who the company intends to serve, its intended beneficiaries. Farmer-owned cooperative Organic Valley exists to serve its producers, the farmers. Fannie Mae exists to serve its customers, the homeowners of America. The employee-owned John Lewis Partnership exists to serve its employees. In the process of serving these primary stakeholders, others are also served, such as customers, the environment, and stockholders, though trade-offs are inevitable.

Finally, there is the ownership and control architecture that oversees this mission. Fannie Mae, for example, is a publicly traded company, controlled by its congressional charter. Organic Valley is controlled by cooperative law, which stipulates a policy for producer-owners of one person one vote, rather than one share one vote.

Case study #1:

THE NEW YORK TIMES CO.

Ownership: Publicly traded shares.
Control: Family control via dual-class shares.
Mission: Create an informed electorate.
Intended beneficiaries: Society.
2006 revenue: $3.3 billion.

A publicly traded company, the New York Times Co. produces the newspaper that is one of the nation's premier cultural institutions. Its mission is using journalistic excellence to help create an informed electorate, and that mission is protected by a dual-class share structure allowing the Ochs-Sulzberger family to retain control. The family holds 16 percent of shares outstanding, but controls 51 percent of a special class of voting shares. The family sees itself as steward of a public trust, and the company's control structure embodies that vision. As newspapers struggle to redefine themselves in the Internet era, this single design element today protects the Times from the forced sale of assets confronting other newspaper firms.

Case study #2:

JOHN LEWIS PARTNERSHIP

Ownership: Employee ownership.
Control: Company constitution.
Mission: Serve happiness of employee-partners.
Intended beneficiaries: Employees.
2006 Revenue: $9 billion.

The UK's largest department store group, based in London, is the John Lewis Partnership, which comprises more than two dozen department stores and 160 organic supermarkets, with sales exceeding $9 billion. The firm is 100 percent employee-owned by its 60,000 permanent staff members, who share in profits. The company's stated purpose is serving the happiness of its employee-partners through satisfying employment in a successful business. Formal employee governance via a Partnership Council is stipulated in the firm's written constitution, drafted in 1928 by founder John Spedan Lewis, whose aim was to create a new governance model to inspire others.

Case study #3:

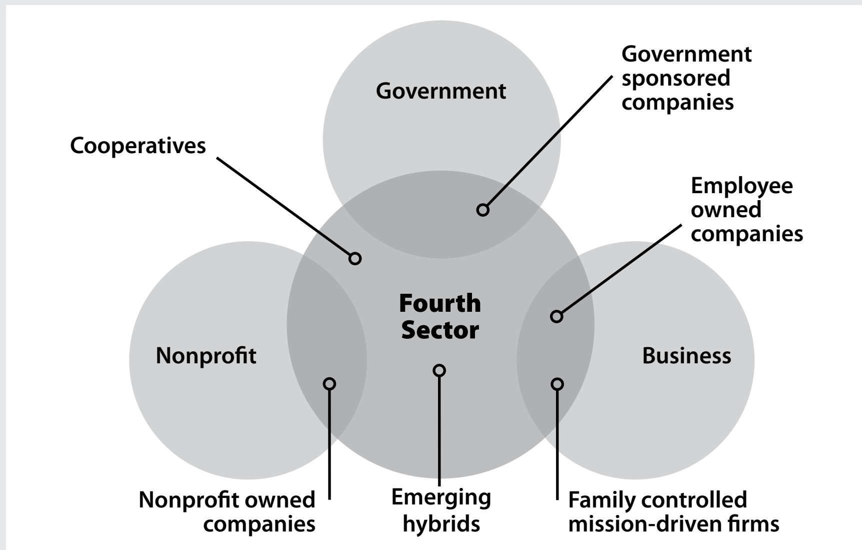
FANNIE MAE

Ownership: Publicly traded shares.
Control: Federal government charter.
Mission: Promote home ownership.
Intended beneficiaries: Customers.
2006 Revenue: $44 billion.

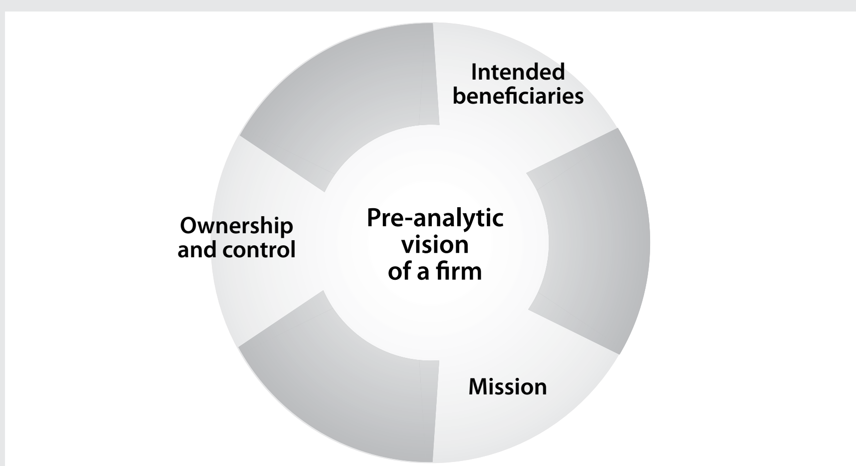
A publicly traded firm which purchases mortgages in the secondary market, Fannie Mae, headquartered in Washington, D.C., provides much of the glue holding together the U.S. housing market. It was created by Franklin Roosevelt in 1938 to make home ownership accessible to more Americans. The nation largely has Fannie Mae (and partner Freddie Mac) to thank for the 30-year mortgage, rare in other nations, and for low mortgage rates.

The company was initially financed with U.S. Treasury funds, which over time were paid back through sales of common stock, until the company became entirely privately held. The company remains subject to control by Congress. In the recent subprime mortgage crisis, there was a clamor to expand Fannie Mae's portfolio, which is seen as providing safe haven for investors because it has refused to purchase mortgages with abusive terms.

MAPPING THE FOURTH SECTOR



THE NUCLEUS OF CORPORATE DESIGN



Pre-analytic vision is the DNA of corporate design. Around it are company mission, the intended stakeholder beneficiaries of company action, and the ownership and control design that holds purpose in place.

Case study #4:

GRUPO NUEVA

Ownership: Public and private.
Control: Trust holding company.
Mission: Contribute to a sustainable Latin America.
Intended beneficiaries: Multiple stakeholders.
2006 revenue: $1.4 billion.

A Latin American holding company headquartered in Santiago, Chile, Grupo Nueva owns controlling rights in three companies in water management, forestry, and cement—one of which has shares that are publicly traded. The group was transformed in 2003 into the VIVA Trust (VIVA stands for "vision and values") by founder Stephan Schmidheiny, who is also founder of the Business Council for Sustainable Development. Designed as a new model to inspire others, the strategic holding company has a mission of contributing to a sustainable Latin America, which it does using business models that help break the cycle of poverty and promote sustainability. The VIVA trust is charged in perpetuity with protecting the vision and values of the firm. Grupo Nueva is designed as a multi-stakeholder company. All operations meet ISO 14001 environmental standards. To serve employees, the company has a public goal of zero accidents by 2009, as well as other programs. It partners with civil society, as in its anti-corruption initiative with Transparency International. And it blends philanthropy with business operations, with a goal of having 10 percent of sales by 2008 come from "socially inclusive businesses," such as training for small furniture makers.

Pathways Forward: Roles Different Sectors Can Play in Corporate Redesign

No one pathway will lead to corporate transformation of the kind we need. It will require a combination of internal and external actions undertaken by many actors: companies, civil society, government, labor, and media. We offer here some key actions different actors might take.

1. Investors—Tackling short-termism.
"Short-termism" is a term gaining currency in business circles. Investors might address this by possibly requiring a long-term focus from their advisers. Perhaps institutional investors could focus on five-year returns, selecting and rewarding asset managers accordingly. Another design element that entrenches short-termism is the stock option package for CEOs, which former SEC Chair Arthur Levitt has criticized for creating "the wrong incentives." Former Federal Reserve chair Paul Volcker has suggested scrapping options entirely, saying they are "subject to abuse and temptation in a way that's almost irrefutable."[5] The Aspen Institute, the Conference Board, and the Marathon Club (UK) have all released reports on antidotes to short-termism.

2. Large Business—Changes to incorporate stakeholder management.
Large companies have a unique capacity to demonstrate leadership in restructuring enterprises for stakeholder management. They might explore having employee or public interest directors, creating board-level committees, doing social reporting, or linking executive pay to environmental or social performance. Also, executives might join others speaking out against short-termism and help introduce approaches for managing analysts. Some major companies are already exploring alternative corporate designs for "bottom of the pyramid" subsidiaries serving the poor in developing nations. One example is the 50/50 joint venture between Grameen Bank and Groupe Danone, the Grameeen Danone Foods Social Business Enterprise in Bangladesh, which is creating a new business in partnership with local communities to bring nutrition and alleviate poverty. It is neither philanthropy nor a full part of the company but a hybrid stand-alone. As Groupe Danone CEO Franck Riboud put it, "I'm deeply convinced that our future relies on our ability to explore and invent new business models and new types of business corporations."

3. Small to medium business—Experimenting with new corporate designs.
The most fundamental changes can be made at smaller entrepreneurial companies, which can adopt new kinds of company charters that integrate social and financial mission. Elsewhere in this report, we look at a variety of alternative designs.

4.Civil society—Working to expand disclosure and social responsibilities of directors.
Activists are the primary force that could promote this issue, as has been seen with the leadership of CERES in the U.S. and the Corporate Responsibility Coalition (CORE) in the UK. CORE, representing 130 nonprofits

Case study #5:
ORGANIC VALLEY

Ownership: Cooperatively owned by over 1,100 organic family farms.
Control: Cooperative law.
Mission: Save the family farm.
Intended beneficiaries: Producers.
2006 Revenue: $330 million.

A producer-owned marketing cooperative headquartered in LaFarge, Wisc., Organic Valley—one of the nation's largest organic brands—is growing 40 percent a year and is owned by the 1,183 organic family farms who produce the dairy, eggs, and meat it distributes. The company's mission is to save the family farm by putting the environment, wholesome quality food, and the farmer first. To meet demand, the company helps farmers convert to organic methods; thus one of the company's "externalities" is a spreading area of healthier soil left in the wake of company growth. Because the company aims to pay a stable, high price to farmers, it seeks to keep profits at around 2.2 percent. Organic Valley governance employs a weak bicameral structure: a central board with advisory stakeholder boards. Its board of directors is made up primarily of farmer-owners, directly elected by the cooperative membership. The company also has regional pools of producers, each with an executive committee that has staff support, which make recommendations to the board of directors.

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and campaigning organizations, worked to expand directors' social responsibilities in law. In 2006, the Companies Act was enacted, which for the first time mentioned duties to society as part of directors' duties, though the law's main focus was requiring non-financial disclosure in cases of material impact on investors. CORE has proposed amendments that would require directors to take steps to minimize harms, and that would give access to UK courts to those overseas harmed by UK companies. There are stirrings of similar work in the U.S. The "Unity Coalition Declaration Post Enron," created by groups such as Greenpeace International, has called for corporate governance reform, and Ralph Nader in May 2007 hosted a conference on corporate accountability.

5. Government—Requiring social reporting or pursuing charter reform.
A key step government could take at the national level is to make social reporting mandatory. The Corporate Sunshine Working Group—an alliance of investors, environmental organizations, unions, and public interest groups, led by Friends of the Earth—aims to have the SEC enforce and expand social and environmental disclosure requirements. Another pathway of charter reform might be pursued on an industry-by-industry basis, with sectors such as oil and gas, tobacco, pharmaceuticals, and autos. As author Charlie Cray explores in another Corporation 20/20 paper, new charters might be devised that would establish terms and conditions governing such sectors. At the state level, the grassroots Citizens for Corporate Redesign in Minnesota has drafted a Minnesota Bill for Socially Responsible Corporations, introduced in 2006 and 2007 by Sen. John Marty and Rep. Bill Hilty, to create a voluntary new corporate charter for socially responsible companies. Hawaii not long ago passed a bill to create a commission to study the need for a similar alternative charter, which was vetoed by the governor.

> Large companies might explore having employee and public interest directors or linking executive pay to social and environmental performance.

6. Labor—Controlling labor's capital.
A powerful avenue of reform that labor has been pursuing is tapping the power of labor's capital, through shareholder resolutions, employee-friendly investment vehicles, and other routes. One way this might take a corporate design turn would be through mandatory worker representation on the boards that govern 401(k) investments. "These funds control so much of the money that's in capital markets," says Ron Blackwell of the AFL-CIO, "if you want greater democracy over the markets, this is one place to start." More broadly, labor might push for a society-wide commitment to a living wage, worker representation on corporate boards, or tax incentives that enable employee buyouts of firms.

7. Media—Changing business reporting.
The media could help break the short-term fixation by reducing its ticker-tape mentality, de-emphasizing reports on financial indexes, and giving equal coverage to social and environmental indicators. A new generation of barometers and scorecards is needed. Data from corporations that adhere to standards set by the Global Reporting Initiative (GRI)—an independent organization affiliated with the UN—could form the basis for a new "GRI Index."

About this report and its co-authors

This report grew out of the three-year process of the Corporation 20/20 initiative, a project to design future corporations which sustain social purpose. It has involved some 200 people from business, civil society, finance, labor, and law. Their contributions were instrumental in shaping this report and are gratefully acknowledge by the authors. The New Principles of Corporate Design were developed in that process. The set of profiles in alternative company designs focused on human well-being were developed in conjunction with the Well-Being Program of Tellus Institute, headed by John Stutz.

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Footnotes

1 Allen L. White, "Transforming the Corporation," GTI Paper Series No. 5, 2006, www.gtinitiative.org.

2 John Graham, Campbell Harvey, Shiva Rajgopal, "The Economic Implications of Corporate Financial Reporting," *Journal of Accounting and Economics,* Dec. 2005, pp. 3-73. Graham (John.graham@duke.edu) is with Duke University; Harvey (cam.harvey@duke.edu) is with both Duke and the National Bureau of Economic Research in Cambridge, Mass.; Rajgopal (rajgopal@u.washington.edu) is with the University of Washington, Seattle.

3 2006 Survey of 1,121 managers and human resource experts by American Management Association and Human Resource Institute; www.amanet.org/research.

4 www.corporation2020.org.

5 John Cassidy, "The Greed Cycle," *The New Yorker,* Sept. 23, 2002, pp. 64-77, www.csun.edu/~dgw61315/Greedcycle.doc.

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What would a corporation look like that was designed to seamlessly integrate both social and financial purpose? Corporation 20/20 is a new multi-stakeholder initiative that seeks to answer this question. Its goal is to develop and disseminate corporate designs where social purpose moves from the periphery to the heart of future organizations.

Corporation2020
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