Better Business: Morals Matter

high pay centre

About the High Pay Centre

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success.

We aim to produce high quality research and develop a greater understanding of top rewards, company accountability and business performance. We will communicate evidence for change to policymakers, companies and other interested parties to build a consensus for business renewal.

The High Pay Centre is resolutely independent and strictly non-partisan. It is increasingly clear that there has been a policy and market failure in relation to pay at the top of companies and the structures of business over a period of years under all governments. It is now essential to persuade all parties that there is a better way.

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Introduction
Why we must restore morality to British business

By Deborah Hargreaves

Bob Diamond, former boss of Barclays, famously said "the evidence of an institution's culture is how people behave when no-one's watching."[1] That was before his bank was fined a record amount for rigging interest rates over a period of five years. Not only was no-one in the bank watching, no-one seemed to care enough to enquire what was going on, even though regulators expressed concerns. In the end, the interest rate scandal cost Mr Diamond his job, but only after his arm was twisted to go.

HSBC similarly turned a blind eye to billions of dollars laundered by "drug kingpins and rogue nations," through its overseas operations. A US Senate committee investigation found the bank accepted $15 billion in bulk cash transactions from subsidiaries in Mexico, Russia and others at high risk of money laundering over a three-year period without conducting proper checks.[2]

HSBC's head of compliance resigned over the scandal, but so far no boardroom heads have rolled. Even Standard Chartered, the byword for respectability in the banking system, has now been fined $340 million in the US for processing transactions from Iran.[3]

Mr Diamond blamed 14 people at Barclays for illegally distorting rates – out of a staff of 144,000 – claiming their behaviour was "abhorrent." The "one bad apple" defence was also used by Rupert Murdoch in his initial claims that phone-hacking was the work of a renegade reporter. This was before it turned out to be endemic at the News of the World as part of a tabloid culture that was out of control.

Similarly, in Parliament ministers sought to play down the expenses scandal until media reports of moat cleaning, duck houses and second homes at the taxpayers' expense, became so widespread, they engulfed Westminster and ultimately left some MPs in jail.

Public trust at record low

Scandal, fraud and corruption have tainted some of Britain's leading institutions in recent years, undermining trust in key pillars of the establishment. Public trust in business and regulators is at a record low. And yet business and banks will have to create the growth and jobs we need to lead the economy out of recession. Trust evaporates rapidly and takes a long time to rebuild, requiring far-reaching culture change.

[1] Bob Diamond, inaugural Today business lecture, Nov 4 2011, Radio 4
[2] US Senate permanent subcommittee on investigations 330-page report, Jul 16, 2012
[3] Standard Chartered to pay $340m fine to US bank regulator, the Guardian, Aug 14, 2012

Even Mr Diamond acknowledged in a BBC lecture that the threat of further social unrest remains if we don't work together to create stronger economic growth and more jobs.

One lesson to be drawn from this year's series of scandals is that culture is set at the very top of an organisation. If the boss is seen to encourage a certain type of behaviour, however tacitly, his subordinates further down the organisation will mirror and magnify that behaviour. If banks are run to make money at all costs and newspapers are required to compete for sales with the most salacious stories, those working there will do all they can to meet those expectations.

Trust and ethics are so often seen to play second fiddle to the red-blooded desire to compete and win that is evident in these macho institutions. While business schools now teach courses in ethics, this is still seen as somehow separate from the main thrust of a business qualification. Yet ethical behaviour needs to be embedded in the culture of an organisation, it needs to be brought in to every decision at the highest and lowest level.

Dull policeman of the trading floor

The compliance department in a financial institution is often regarded as the dull policeman of the trading floor, to be outwitted if at all possible. It brings in no money and seeks to impose restraints on behaviour. David Bagley, HSBC's head of compliance who resigned over the money laundering scandal, appears to have been reduced to adviser to the bank's global operations, rather than enforcement officer. Compliance is too often seen as an obstacle to be got round rather than as a vital part of the functioning of a bank.

Regulators are not held in high regard in the business world and even at Westminster. And this is another lesson to be drawn from recent scandals. Self-regulation and light-touch rules are an excuse for flouting the principles of duty and responsibility. Far from allowing business to flourish with minimal red tape, light-touch regulation encourages sloppy practice and scant oversight. In the long run, this proves more damaging for an institution than consistent rules. The argument that an industry must not be hampered from operating efficiently by too many rules and regulations has been proven wrong.

Regulators should not be in thrall to the businesses they are supposed to be monitoring. A hands-off approach can prove much more expensive in the long run. Tax generated by a flourishing financial sector in the City, for example, has been more than wiped out by the £1.2 trillion cost of bailing out and supporting our banks.[4]

It comes as little surprise that the banks were rigging interest rates when you realise the system was refereed by their own trade association. As the scandal drags in more British banks, there is a belated effort by regulators to reform the way the rates are set, but the crisis has severely damaged the reputation of the City of London overseas.

Those at the top of our businesses, banks and political establishment have had too much benefit of the doubt. The language of public debate and orthodoxy of behaviour have been too much in their favour. They set the tone of the argument and to disagree is to be labelled anti-business.
It is time to throw the argument back at the establishment; to call for a culture at the top of our businesses and banks that we can respect. We need a set of rules that is effective and stops people behaving badly when they think no-one is looking.
This means proper regulation of banks, newspapers, MPs and the corporate sector. But above all, it means that those at the top should show leadership and start to reflect a culture that is ethical, inclusive and collaborative rather than the winner-takes-all competition for supremacy. ■

[4] Barclays Libor scandal: how can we change banking culture? Aditya Chakrabortty, the Guardian, Jul 2 2012

The only way is ethics?

By Simon Caulkin

Any discussion has to start from the recognition that in the drama of business, ethics has only a walk-on role. Look around: for all the attempts to talk up social responsibility, everyday evidence tells a stark story. Whether from popular representations such as *The Apprentice* or *Wall Street's* Gordon Gekko, persistent financial mis-selling, increasingly frequent scandals culminating in the fraud and malfeasance that contributed to the crash of 2008, petty dishonesties in small print or today's unjustifiable inequalities in pay, it is impossible to avoid the conclusion that morality in business is honoured almost entirely in the breach.

But this should be no surprise – in fact the surprise would be if it were any different.

Institutionally and by design, today's version of management is an ethics-free zone. In unholy alliance, practice and theory form a self-reinforcing embrace whose pull is almost impossible to escape – especially for those to whom the warm cocoon of vested interest has become invisible.

For this situation, blame a mixture of academic theory and ideology. For the last half century, business academics keen to establish management as a respectable discipline have striven to make it as much like a physical science as possible. As London Business School's late Sumantra Ghoshal noted in a much-quoted 2005 article, business schools have in effect reduced business to "a kind of physics" in which human choice and intention play no part. "Since morality, or ethics, is inseparable from human intentionality, a precondition for making business studies a science has been the denial of any moral or ethical considerations in our theories and, therefore, in our prescriptions for management practice."[5]

Already wedged shut, the door to ethical intrusion was then bolted by the ideological form those prescriptions took. The sharply focused shareholder capitalism that took shape in the 1970s and has dominated governance in the English-speaking world ever since, is founded in a grimly reductive view of human nature in which selfish self-interest rules. In this model, the central issue of governance is the 'agency problem' – bending the self-aggrandising tendencies of manager 'agents' to the will of shareholder 'principals'. To accomplish this, the brainwave theorists hit on was to merge managers' interests with those of shareholders by paying them in equity, usually in the form of stock options.

[5] Bad management theories are destroying good management practices, Sumantra Ghoshal, Academy of Management Learning and Education, vol 4, 2005

Greed is good

Corporate raiders, followed by private equity artists and CEOs, adopted these prescriptions with relish. But notice what happened in the process. In a parody of Adam Smith, the manager's job was now to look after No 1 and in so doing see to the interests of shareholders, forsaking all other. Managers were not just assumed to be self-interested: that is what they were explicitly and without exception required to be. Greed is good, essential and leaves no room for fuzzy ethical or social concerns. To make it clear to the vacillating, Milton Friedman spelled it out: "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."

While the corporate social responsibility movement has attempted to round off some of these indelicate edges, its effect is largely tokenistic. Witness the near-universal shrug in reaction to an unpopular takeover or a downsizing decision: "Of course, it's the directors' fiduciary duty to do what's best for shareholders."

Actually this is a myth fostered by the same false shareholder ideology: in law fiduciary duty is owed to the company as an autonomous legal person, not shareholders. But the damage has been done. Whether in governance structures, directors' behaviour or the public imagination, the internalisation of the Friedmanite idea that the job of managers is to externalise corporate costs without thought for social or ethical consequences is almost complete.

As Ghoshal noted, "By propagating ideologically-inspired amoral theories, business schools have actively freed their students from any sense of moral responsibility." As is only now becoming clear, the practical consequences of this ethics-free experiment have been momentous, altering the shape not only of companies and the economy, but of society itself.

Unease over Apple's business model

At the company level, consider Apple. Apple is a remarkable company that gets many things right. Its ability to forge relationships with customers (I've been proud owner of every generation of Macs since the first in 1984) and innovation capacity have turned it from a near basket case in the 1990s into the biggest firm in the world measured by market capitalisation. Last year it earned profits of $400,000 for each of its 63,000 employees, more than Goldman Sachs or Google.[6] It has more cash in the bank than the US.

Yet its business model evokes as much unease as admiration. It's not just that it no longer creates

[6] Apple's success isn't translating into US jobs, New York Times, March 12, 2012

manufacturing jobs in the US, even though with labour a vanishingly small proportion of total production costs – even at US rates – it could well afford to. Only a company with a social conscience shrivelled to the point of autism could have been caught so unawares by the abuses revealed at its subcontractors' Chinese assembly plants. Its response – to demand improvements while declining to alter its own draconian terms – is even more revealing, giving Foxconn little option but to replicate its giant customer's behaviour in even more extreme form.[7]

Yet it is not cost that causes Apple to bear down so hard on suppliers – margins on a $630 iPhone are calculated at an eye-popping 70 per cent – but the imperative (and incentive) to maximise returns to shareholders.

Prominent among the latter, of course, are the company's own management. On becoming chief executive last year, Tim Cook was awarded stock options worth $376 million to vest over the next 10 years. At last count, they were worth double that. As incentives go, that's pretty powerful.

Downsize and distribute

Apple may seem an extreme case. But its behaviour is representative of a more general shift. In the 1970s and 1980s, responding as expected to their new incentives, corporate managers started to view their job of resource allocation in a different way. Instead of retaining profits and using them to expand the business, benefiting all stakeholders ('retain and reinvest') they moved to an exclusively shareholder-focused strategy of 'downsize and distribute', consisting of slashing headcount, outsourcing and offshoring jobs and functions and financially engineering themselves to boost short-term return on equity.

Profits were now distributed in dividends and above all burgeoning share buybacks, which Professor William Lazonick has calculated between them ate up 96 per cent of the net income of S&P500 companies in the 1990s.[8] That left crumbs for ordinary wages, which stagnated or fell, and R&D. Unsurprisingly, the innovation rate has slumped since the 1980s.

Boardroom pay soars

But it's not just manufacturing and jobs, as at Apple, that chief executives have offered up on the altar of shareholder value. Long-term careers and now pensions for the workforce have gone the same way. Meanwhile, free of ethical or social restraint, boardroom pay has soared to undreamed of heights. The plight of the 99 per cent and the bounty of the 1 per cent are two sides of the same ethics-lite coin. "The new economy business model tracks with increasing inequality," confirms Lazonick. More concretely, as

[7] Apple: Why doesn't it employ more US workers? Aditya Chakrabortty, the Guardian, Apr 23, 2012
[8] Everyone is paying price for share buy-backs, Prof William Lazonick, FT, Sep 25 2008

Aditya Chakrabortty put it in *The Guardian*, as in the case of Apple,

“moving jobs offshore has become a way of directing ever more money to those at the top of American society”.[9]

For Apple, read society as a whole. Yet there is a grotesque irony here. Making business morals-free doesn’t even benefit those in whose name the ethical dispensation has been declared. Studies show that companies run along the lines proposed by the agency model don’t do better than governance ‘laggards’. Over a 30-year-period companies have cumulatively performed less well for the body of shareholders (although not for CEOs) than in the years when managers were supposedly feathering their own nests.

Management is not a science

The reasons are hidden in full view. The ‘business of business is business’ model may produce fancy equations, but it defies common sense. Unrealistic starting assumptions yield invalid prescriptions that duly produce monstrous outcomes. People aren’t exclusively self-interested. Company success is the product of contributions from many constituencies, not just top managers. In the days of high-speed trading and hedge-fund arbitrage it’s manifestly absurd to maintain that shareholders bear all the risk and are therefore entitled to all the reward, and just as barmy to assert that business can somehow operate at arm’s length from the society in which it is embedded.

Companies aren’t machines and management is not a science.

Ethics-free management is as disastrous as ethics-free politics.

If business acknowledged a truth evident to everyone else – that it can only prosper in the long term if it simultaneously pays attention to the interests of customers, employees, shareholders and communities, using moral judgements as in any other human activity – there would be no need for something separate called ‘business ethics’. But until then, bluntly, the latter will continue to be patronised and ignored in its role as business’ tolerated fool. ■

[9] Apr 23, 2012

Making the company work for employees

By Paul Nowak and Frances O'Grady

More and more employees say they want to work for an organisation with high ethical standards, but finding an employer that fits the bill is not always easy. On the one hand, businesses say they want to be 'good'. Or, at least, to be seen as 'good'. Famously, Google's in-house motto is 'Don't be evil' and Goldman Sachs's chief executive once went so far as to claim that he was "doing God's work".

On the other hand, actions do not always match words. Take Amazon. With over 137 million customers worldwide, revenues of over $48 billion in 2011 and profits in excess of $10.7 billion, the company is ranked the world's No 1 retail brand by BrandZ. Amazon claims it combines strong profitability with a practical commitment to 'the good of society'.

But beneath the corporate social responsibility hyperbole lies a different reality. This is a company that made £7 billion worth of sales in the UK but where warehouse operatives' pay falls short of a living wage, and not a penny of corporation tax was paid last year.[10] It resorted to US-style union busting when staff at its Milton Keynes distribution centre tried to organise a union; sacked temporary workers who had the misfortune to fall ill; and whose aggressive corporate strategy is routinely condemned by its competitors.

Short-termism and shareholder value trumps

Morality may be seen as important to corporate reputation, but when the chips are down, the UK's corporate governance framework ensures that short-termism and shareholder value trumps long term public interest every time. This may be one reason why, according to the Mori Veracity Index, only 29 per cent[11] of the public say they trust bankers and business leaders.

While it can be argued that corporate immorality is an inevitable consequence of capitalism or that to draw distinctions between 'predators' and 'producers' is simply too difficult, such laissez-faire fatalism only lets the corporate bad boys off the hook. Instead, we need to think imaginatively and bravely about what government and citizens can do to create a new framework and culture that punishes corporate sins, while rewarding those companies that contribute to the common good.

Social value

One way of doing this would be for government to extend the

[10] Amazon: £7bn sales, no UK corporation tax, Ian Griffiths, the Guardian, Apr 4 2012
[11] Mori Veracity index, Jun 27 2011, www.ipsos-mori.com

principles underpinning the Public Services (Social Value) Act 2012 to the private sector. Passed with cross party support and government backing, Conservative MP Chris White's (heavily amended) private member's bill gained royal assent in March and will require public authorities to ensure that they procure services in a way that provides 'social value'. While there needs to be some hard thinking about how 'social value' is defined, evaluated and monitored – it is right that public authorities should have regard to the wider consequences of procurement decisions, including the impact on jobs, communities and the environment. And if it is right for public authorities to take on this broader responsibility for their actions, then surely it must be right for the private sector too.

Workforce democracy

This leads us to our second suggestion: one stakeholder often actively excluded from meaningful discussion about future corporate strategy, is that most directly affected when it fails – the workforce. Giving ordinary workers a say over their bosses' pay through representation on remuneration committees would be a good start, but politicians should be bolder. We believe the active workforce involvement in strategic oversight of companies makes for more successful and sustainable companies.

There is clear evidence, for example, that where unions are recognized, collective bargaining can help promote positive workplace innovation and change, including through initiatives to develop greener products and services, and cut carbon emissions.

In a year that marks the 35th anniversary of the publication of the Bullock report of the Committee of Inquiry on Industrial Democracy and five years on from the global financial crash, we believe the time has come for a fresh look at how to go beyond staff surveys and suggestion boxes, to introduce a degree of genuine workforce democracy into Britain's businesses. While few would argue that the German model of co-determination could be imported wholesale into the British arena, reform of corporate governance to allow workers a say is long overdue.

Finally, while the State must revitalise its role as the guardian of decent work and decent business it cannot do the job alone. There are social agents beyond government – from living wage campaigns to environmental groups and the Tax Justice Network – which can be empowered to play a key role in holding companies to account and moving them towards a new corporate morality. With over 6 million members, Britain's unions represent the largest, democratic and progressive force for change in the country.

Modern unions recognise that we have a responsibility to do more and ensure that our members are informed and active citizens:

Nurses should know that where they do their weekly shop is not replacing staff with those on unpaid 'work experience'; shop workers should know whether their mobile phone provider is not paying its fair share of UK taxes; call centre staff should know if the multi-national planning to take over the running of their local hospital is exploiting sick people elsewhere in the world.

Stronger unions, campaigns and communities can help raise ethical standards in business and, together, act as the conscience of corporate Britain. ■

Commit locally to build trust

By Guy Opperman MP

The phrase 'corporate social responsibility (CSR)' – essentially social action – is the new buzz-word in business. The Department for Business, Innovation and Skills defines it as:

"the voluntary actions that business can take, over and above compliance with minimum legal requirements, to address both its own competitive interests and the interests of wider society."

The last few words of that definition, "the interests of wider society", are the most interesting. The motives for companies to engage in social action can vary, but there is little doubt that, whatever those motives might be, social action is good PR for any company, of any size. An obvious explanation is that social action shows a company cares for the welfare of the local, and wider, community around them – whether that is a small rural village in the North East or the whole of the UK – rather than just making as large a profit as possible, whatever the cost.

Recent events have seen public anger towards big business – particularly the banking sector – become as vocal as it has been for a long time. Whether you think social action has merely been part of a veneer covering the true Machiavellian machinations of some businesses or believe there are companies that see it as their duty to give something back to the local community, it would be tragic if the violations of a few in the corporate sector were allowed to cloud the judgement and perception of the public to all business.

Giving something back

Northumberland is a good example of large businesses engaging with and being part of their local community. Big business has a lot to learn from how we do things in my Northumberland constituency of Hexham. We have many large and small businesses that have used their success to give something back to the community and support charitable causes and events in a way that can only be matched by a collective of individuals and groups.

In short, we have employers who feel a duty greater than a financial one: actively integrating into the life of the local community to create a sense of cohesion. Three examples in my constituency are: Egger, SCA Hygiene and Kilfrost.

Egger made Hexham its first foreign investment in 1984. The company is Austrian-owned, but the Hexham operation is run by local people. The company is Europe's most advanced chipboard manufacturer – employing over 7,000 people across Europe – and they are well known for their local engagement and commitment to employing local talent. They support numerous local causes, such as The Calvert Trust Kielder which provides outdoor activities for disabled people and Tynedale Hospice at Home – also supported by SCA Hygiene.

SCA, maker of leading toilet tissue brand Double Velvet, is based in Prudhoe. Both companies – each employing 400 locally – are prime examples of large organisations trying to achieve commercial success, but also looking after the community in which they have chosen to base themselves. They are at the forefront of the drive to create jobs for young people through the creation of apprenticeships for locals.

Kilfrost is a de-icer manufacturer and, quite frankly, nothing happens in Haltwhistle without them. They are committed to ensuring that their success and development is mirrored by those in the community. The company is a local achievement run by local people. It supports many benevolent causes, such as the 150-year-old water tower at Haltwhistle Station that has been officially opened as a base for local young people.

Reciprocity and responsibility

All three companies are in tune with a wider philosophy of reciprocity: striving to support a healthy and happy local community, which in turn provides a motivated workforce. In short, they have pride in the place where they are based and that community is, in turn, proud of them.

The record of businesses in Northumberland is a strong one and provides models on how to be a successful and responsible business in the current climate. Of course, the examples cited are all of companies firmly established within an easy-to-identify locality. They have worked out that their fate is firmly intertwined with that of the community. The problem we have with many large, or even global, businesses is that they do not have the sense of belonging to any particular community.

The big banks such as Barclays, Lloyds and HSBC, for example, all attempt to engage in positive social action, raising and donating money for and to many worthy causes, as well as sponsoring a variety of events that benefit charity and communities alike. But what is lacking is the sense of reciprocity and responsibility to a community.

In Northumberland the owners of the likes of Kilfrost, Egger and SCA are all well-known locally, bringing a key human element of accountability to that 'business in the community relationship'. The chief executives of Barclays, Lloyds and HSBC are simply too big to do the same. This is not to lay blame at the doorsteps of big business, who are a key element of our economy, but the difficulty for them is that it is harder for the public to engage with them and get a sense that big business itself feels it has a stake in, and responsibility to, local communities.

Businesses which show a sense of responsibility and reciprocity to the communities in which they operate are more likely to benefit where choice is an option.

Big business needs to find a way of showing that they have a stake in communities, and then making the public believe it. ■

Motivating directors through corporate social responsibility

By Ros Altmann

As shareholders force companies to focus on how executives are rewarded, it is important to look at other valid measures of success in addition to short-term financial returns. These could include employee and customer satisfaction, but I would also like to see the company's record of success on Corporate Social Responsibility (CSR) increasingly reflected in executive compensation. This can be another measure of long-term performance for a business in the modern world.

A successful, meaningful CSR programme can enhance the corporate image as well as creating more sustainable long-term value. Only a minority of companies as yet include social and governance factors in executive compensation packages, but perhaps this needs to change.

Introducing an emphasis on CSR offers many potential benefits. It has been well-documented that CSR helps in motivating, developing and retaining good staff. Studies show improvements in employee morale, loyalty, recruitment of top talent and even productivity. Motivated employees are often vital to achieving corporate objectives and people generally prefer to work for firms that make a difference, those which have a corporate conscience and strong values. A successful CSR programme can help attract good workers to a firm.
A well-communicated CSR message can also help a company's standing with institutional investors, as long as it is explained appropriately. In the past, most shareholders had no idea about a firm's CSR initiatives but that is less so nowadays, as companies are starting to communicate their strategies better and recognising the benefits to their corporate image. Shareholders are beginning to understand the power of genuine CSR programmes to enhance a brand image, improve customer loyalty and increase employee retention. Many firms have also started publishing CSR reports to communicate to shareholders and the general public their commitments and targets for these programmes.

CSR can transform a brand

If a company gets it right, a commitment to CSR can transform the company and its brand. Company executives understand that the organisational and technological innovations they put in place can yield both increases in sales and profits. Many sectors will benefit from a company's emphasis on responsible production or sales processes.

However, while companies are embracing CSR, there are still many doubters and there remains significant scepticism about the value of such programmes. There are still many entrepreneurs who sign up to Milton Friedman's famous edict from 1970 that: "The social responsibility of business is to increase its profits." Such free-market ideology can lead to CSR being little more than a box-ticking exercise, rather than programmes that are of genuine social benefit.

Sometimes, projects are supported just to pay lip service to CSR – with a disconnect between the rhetoric and the reality of what is actually being done. Companies sacrifice longer-term CSR commitments to short-term profits.

There also needs to be more rigorous reporting requirements for CSR measures to stop companies picking and choosing the way they undertake their community involvement, commitment to diversity, environmental stewardship or charitable works.

If companies only pretend to engage in CSR, the benefits from a truly committed approach will be lost.

Of course, there are times when companies cannot afford to spend too much money on their CSR initiatives, and during difficult economic periods some plans may need to be delayed – a socially conscious but bankrupt business is not much use to anyone! But, overall, having a long-term strategy for improving the ethical and moral nature of a company's operations is more likely to boost long-term performance than detract from it, if the right projects are chosen.

Shared value

The ideal is to try to find CSR initiatives that are both good for long-term profitability and for social welfare. Some CSR projects can offer 'shared value', with benefits for both the business and society. For example, initiatives that will reduce carbon emissions are also likely to save money for firms on their energy bills. Sponsorship of education in local areas could mean being able to attract the best local talent. Facilitating voluntary work for local communities or sponsoring local construction projects, could inspire customer loyalty for a company's products.

But that does not mean that CSR is just about enlightened self-interest. CSR is not just about improving the social impact of a company's own operations – such as its factories, offices, or distribution networks. In many overseas subsidiaries, CSR can improve safety and the operation of mines or industrial and chemical plants. It can also influence suppliers to behave better or to develop products that are less environmentally-damaging or to improve the local communities around the firm.

Code of conduct should work overseas

Encouraging a company to introduce a public code of conduct to which suppliers must adhere, could be a tangible demonstration of commitment to responsible business. Manufacturers who genuinely ensure safer conditions for overseas production, and pay more attention to human rights, insisting on no child labour and minimising pollution, are likely to benefit in the long-run, even if these measures affect short-term profitability.

Of course, it is sometimes problematic when operating in far-flung places, to ensure that local suppliers – even after signing up to a code of practice – do actually stick to the rules. Sometimes, child labour or environmentally damaging operations can continue, but as long as the CSR projects are being monitored, such practices can be identified and addressed.

Executive compensation needs to be linked to CSR

That is why it can be important to include an assessment of the impact of CSR initiatives when setting executive compensation, because this gives management a direct incentive to engage with the responsibility agenda. It is important for companies to measure the impact of their operations and report on them, so that all stakeholders can see the benefits. This can then more easily form part of executive compensation and bonus packages in future.

In practice, leadership in CSR has to come from the top. Unless there is commitment from the highest levels of the company, there is a risk that CSR will be sacrificed in the interests of short-term profitability, or be little more than a form-filling exercise. This would squander opportunities to benefit both the firm and society in future. We need to measure what we do in our companies and our communities and then reward chief executives for their performance in these areas. Bonuses should be paid for success in tangible ways.

A combination of the current economic environment, public demand for transparency, the rise of social media and third-party verification, means that increased emphasis on CSR could offer vital improvements in long-term corporate and social performance, as well as enhancing shareholder, employee and customer satisfaction with corporate leadership. A company that is genuinely concerned about long-term profitability and focuses on this when considering corporate social responsibility, will be more likely to think longer-term in other areas of its operations too. We need to move away from the short-term culture and look realistically at how we can use businesses to help develop a better future for us all. ■

Companies need to find a conscience

By Caroline Lucas MP

Today's businesses, no matter how good or bad, are driven by the impetus to grow. The environmental damage done by individual businesses through pollution, the destruction of habitats or endangerment of species, is as nothing to the danger they pose through their drive to expand, whether or not we need or can afford their products.

Firms have repeatedly shown they can do more with less, so that the environmental impact of products ranging from packaging to aero-engines can be reduced substantially. But such advances are lost when the total amount produced grows faster than companies' ability to cut the environmental harm. When this happens we are left with the paradox of firms trumpeting their environmental credentials while the earth remains on a path to ruin, whether it is the depletion of the oil reserves used to make the packaging, or the contribution of aviation to climate change.

Seeking a new business model

The push to stimulate demand for products or services without taking into account any underlying need for them and ignoring the long-term capacity of the earth to meet that demand, is endemic.

Indeed, it seems at times beyond the capacity of many business leaders even to engage with the issue of growth at all costs, even though economists have been concerned by it at least since the publication of the Affluent Society by J K Galbraith in 1958.

Airlines and aircraft manufacturers are investing in fuel-efficient aircraft because of a mix of regulation, rising fuel costs and, in some cases, a genuine concern about the impact of their activities on the environment.

But is there an airline in the world that is seeking a business model in which they do not chase more passengers, or try and sell more planes?

Governments share this myopia. From time to time they intervene to stop businesses from doing things that are bad for the environment (though less in recent years than they did in the 1970s to 1990s). They also try and encourage more efficient use of natural resources, through investing in research and providing tax breaks and subsidies. But is there a government in the world planning to restrict economic activity to a level that the planet can sustain?

Consumers ignorant and governments weak

As individuals, we can make choices about our own consumption. But we are rarely given any clues about the way in which those choices affect our planet now, let alone in the future. Food products may include information on how many calories they contain, but we are not told about the pesticides used, or how many square metres of the rainforest went up in smoke, to deliver that product.

With consumers ignorant and governments weak, there is a desperate need for companies to discipline themselves and find new ways to operate.

But that requires responsibility and accountability, as well as some creative thinking.

From the very start of 'joint-stock' companies back in the eighteenth century, there were doubts about the wisdom of such enterprises, and particularly, concerns about the moral implications. An individual who runs their own business has direct responsibility for their decisions. If they chop down trees without replanting or pollute the local river, they are open to the moral censure of their community, even if there is no legal remedy.

Unlike the individual owner, the modern managers' prime responsibility is to maximise the return on the investments of the shareholders who appointed them. If that means tough decisions – such as shifting production to a country with lower environmental standards – then so be it, unless the shareholders tell them otherwise. Ethics – beyond the legal requirements imposed on them - don't get a look-in.

Shareholders, too, have changed. The individual shareholder is increasingly a thing of the past as more and more investments are managed by large scale investors. These too are companies with a legal responsibility to maximise profit at any (legal) price, and rarely impose their own morality, let alone seek to represent the moral concerns of those who have trusted them to look after their money. As a result, the vast majority of people in Britain have no idea where their money has been invested, and no idea of how it is being used. This means, they have no sense of moral responsibility for what businesses do in their name.

Consumers could exert more pressure

One curious effect is that people are more likely to use their purchasing decisions to seek to influence companies than the fact that they have money invested in them. This means we might have a boycott of a cosmetic firm because of animal testing, or an oil firm because of its funding for groups trying to trash climate change research. But those same consumers may well, unwittingly, have part of their pension, ISA or other savings invested in those same companies which they could use to exert more pressure.

Even where individuals do become active shareholders, the odds are against their being able to influence the way managers run their companies. To do so would usually require at least 50% of the votes. With so many passive investors, a campaign, for example, to stop using palm oil would easily be lost, even if not directly opposed by other investors. As most shares are in the hands of investment managers, who share the same corporate culture and assumptions, attempts to impose ethics are unlikely to gain much traction.

The dominance of the mantra that managers are responsible only to their shareholders, and the ease with which corporate responsibility can be used as a veneer by the most unsavoury corporation with a bit of funding for the arts, makes it surprising that firms do not have an even worse record.

There are plenty of managers who do actually bring morality into the workplace, even if this means profits are not pushed absolutely to the limit.

This has to be encouraged; and we need to work with companies to find ways to ease them off the growth-at-all-costs model and into ones that are genuinely sustainable.

The City of London, now the epicentre of corporate atheism, has as its motto *Dirige nos Domine*: 'Guide us, Lord'. It reflects a time in which people believed that businesses should be for a higher purpose or be subject to a higher force that would judge their actions. Those days need to return: in place of God, we need businesses to understand that they are part of society, and must reflect our moral and ethical framework. Being a manager or a shareholder does not give anyone the right solely to worship money, particularly if it is other people, and our planet, that are sacrificed on that altar. ■

Executives should be shamed into being less greedy

By Jonathan Ford

After years of apparent apathy, investors have started to take a lively interest in executive pay. The so-called "shareholder spring" of the last few months has witnessed a number of spectacular revolts against overpaid bosses. Some dud chief executives have been forced to step down altogether. Others (including even relatively successful chieftains such as Sir Martin Sorrell at WPP) have been forced at least to acknowledge the scale of investor anger.

Meanwhile, the government has brought forward proposals that would give investors in listed companies more of a say on remuneration policy. While not offering a true lock on pay packages, these may at least give shareholders a bit of extra clout when it comes to setting salaries and bonuses in future.

Such a reckoning is, of course, long overdue. Much of the executive pay inflation of recent years has been unwarranted. But periodic assertions of investor power – while welcome and important – may not be enough to change the high-pay culture that has taken root in recent decades.

Problem of incentives

The snag with piecemeal revolts of the shareholder-spring type is that investors inevitably pounce on egregious cases where pay and performance have got totally out of whack. Revolts such as the one against Sir Martin are relatively rare. Average excessive pay, by and large, goes unchecked.

This is not simply because fund managers (many of whom discreetly enjoy similar rewards to chief executives) are overly indulgent about what the FT columnist John Plender has memorably termed "entrepreneurial rewards for bureaucratic performance".[12] It also reflects a problem of incentives.

Most listed companies operate hierarchical pay structures, with only a few stratospheric salaries at the very top. For many fund managers these are not worth haggling over. Only in investment banking, where the sheer number of high salaries menaces the bottom-line, has pay has become a real battleground.

Shareholder oversight may therefore need reinforcement if attitudes are to be changed. But where is this to come from? Higher taxes would hit not only the overpaid bosses of listed companies, but those whose behaviour we might want to encourage, such as successful entrepreneurs. The law is too blunt an instrument.

[12] A byword for greed and complacency, John Plender, FT Apr 6 2009

But just because society balks at formal legal sanctions does not mean that it is indifferent. Most of us compete in some way for profit in the marketplace. Greedy behaviour of the sort exhibited by overpaid bosses is at all our expense.

Shaming greedy executives

One way in which shareholder oversight can be reinforced is for society to ventilate these feelings more forcefully. This would serve more than just a therapeutic purpose. Greater willingness to shame greedy boards and chief executives might have an effect on their behaviour.

Chief executives are, after all, no different from most people. They come from a relatively small community and like to think well of themselves.

A fear of public ostracism may explain why the chief executive of Royal Bank of Scotland, Stephen Hester, voluntarily surrendered a £1 million bonus earlier this year, even though the majority shareholder, the British government, had effectively consented to its payment. Or indeed why Bob Diamond gave up £18 million of bonuses and salary to which he was legally entitled after resigning from Barclays over the Libor scandal.

History suggests that shaming can have an impact on behaviour. Take, for instance, America's experience from the 1930s to the 1970s. From the turn of the last century to the 1929 crash, the US experienced a pay boom every bit as extreme as our own. Salaries rocketed in finance and the new giant corporations that were being stitched together by money-men like JP Morgan.

Although Morgan famously preached that bosses should not earn more than 20 times the average workers' pay, he dismally failed to put his own dictum into practice. The US Steel Corporation, which he assembled in 1901, paid its chairman a base salary that, at $100,000 a year, was 139 times that of the average employee.

Cult of the celebrity CEO

In a recent paper, the US academic, Katherine Savarese, has described how the pay boom was helped along by the emerging popular press, which relentlessly talked up this new class of salaried tycoons, igniting the cult of the "celebrity CEO".

The CEO cult did not long survive the 1929 crash, however.

As the US economy tanked and the public grappled with austerity, adulation turned to anger. The press dropped its fawning attitude and started to channel popular rage about the failure of companies to curb high executive pay in the face of the downturn.

In 1934, with public anger mounting, Congress asked the Federal Trade Commission to investigate executive pay. Disclosure of top salaries – until then a closely-guarded secret by most corporations – subsequently became mandatory. Separately, financial regulation was tightened in ways that made banks and brokers less profitable – and hence less able to support sky-high salaries and bonuses.

The public and the media were not alone in expressing their disapproval of greedy bosses. The mood affected Washington too. President Franklin Roosevelt's administration shunned the Wall Street tycoons and corporate titans who, under previous administrations, had come to see easy access to the White House as their right.

Bosses fought back hard against these assaults, employing arguments that still seem familiar today. Nonetheless, the tide turned. The pay inflation of the pre-crash period first stopped and then started to be rolled back. Throughout the 1940s, US chief executive pay actually fell. And from then until the mid-1970s it rose by less than 1 per cent a year on average.

Public revulsion at high pay

How much public revulsion at high pay helped to bring about this "great compression" is open to debate. But it seems reasonable to believe that the revival of shame culture brought about by the pay disclosures and shareholder lawsuits of the 1930s – perhaps then extended by the shared hardships of the war – helped to cement a change in attitudes.

What is certain is that this social norm, once established, lasted for decades. It decreed that bosses should be relatively modest in their pay demands. So pervasive was it that this barely seems to have needed policing. Chief executives sometimes grumbled that they were paid less than their predecessors. But few sought to challenge the consensus.

Was America riddled with anti-business sentiment as a consequence? Far from it, those were years in which US capitalism enjoyed unrivalled popular consent. Nor did more modest levels of executive pay evidently slow the pace of innovation or inhibit competition – apart perhaps from in the financial sector.

Several lessons can perhaps be drawn from this experience. One is that pay can be rolled back – even though this takes time.

To call for such a narrowing in pay differentials is not to will an anti-business backlash. Business conditions do not burgeon or languish depending on how much the boss is paid.

Greater modesty on the part of chief executives might actually help to restore capitalism's good name.

Many of the significant reforms of the 1930s might not have happened had the public and media not clamoured for change. By keeping its distance from bosses, the Roosevelt administration blunted the power of the business lobby against reforms that ultimately strengthened regulation and governance.

Those law changes in turn helped to cement new social norms about pay and compensation practices. And these norms, as we have seen, went on to endure for decades.

Masterpieces of obfuscation

In the 1930s, companies fought to keep pay secret so that it could not be publicly challenged. Nowadays, the chosen tool of concealment is complexity. The remuneration reports contained in most company accounts are masterpieces of obfuscation, drowning investors in irrelevant detail, all duly rubber-stamped by highly-paid and conflicted consultants.

These schemes should be simplified and the criteria used for determining them made clearer and more objective. Where discretionary bonuses are paid, the board's reasoning should be explained. As the High Pay Centre has urged, a single figure should be put on the value of remuneration packages so investors can see what they are in for. More generally, there should be more sparing use of bonuses and financial incentives in general.

Transparency not only makes it easier to spot when norms are being breached. It also deters abuse by making chief executives more conscious of the need to justify their packages.

Some think this process should be formal and explicit. One idea touted by my FT colleague, Philip Stephens, is to oblige chief executives every year to make a short personal statement in the remuneration report justifying what they have been given. The head of the remuneration committee would then approve and counter-sign this document.

There is much to be said for such an approach. Forcing bosses to put their reputations on the line might make some think twice before putting in outrageous claims. The requirement to endorse them might also stiffen the spine of the odd board in resisting such demands.

Another idea would be to publicise executive compensation deals in advance of the executive being appointed, and then put them to a binding shareholder vote. For the executive in question, a negative vote would not only deprive them of the job, but risk undermining their marketability with other companies.

Westminster needs to change

But it is not only companies that need to change. Westminster and Whitehall need to do their bit too. There is a case for a parliamentary select committee undertaking regular reviews of executive compensation, before which highly-paid bosses could be invited to give evidence.

The government should be more circumspect in its dealings with bosses who flout pay norms. This includes not soliciting their advice or helping them to tout their wares overseas. This latter sanction would serve a useful purpose in illustrating how a chief executive's selfish conduct can hurt shareholders too.

Some chief executives are undoubtedly talented – particularly those who have built successful companies organically from scratch.

But many who run large corporations are performing what is essentially a bureaucratic rather than an entrepreneurial task – a distinction that has often been lost in recent years.

The media has sometimes been beguiled by relative measures of pay. There should be more focus on absolute levels of remuneration. We have all been too reluctant to shame bosses who accept undeserved rewards.

This reluctance to damn overpaid bosses touches on one of the arguments against shaming: that it is unfair. It leads to certain "offenders" being treated differently from others. So while Fred Goodwin lost his knighthood for messing up at RBS, for instance, others who behaved equally shamefully before the financial crash did not lose theirs. Another worry is that shaming can affect individuals beyond the person being sanctioned – such as family members or friends – who may end up sharing in the cost of his or her bad conduct. This, it is argued, is too indiscriminate.

Neither however is compelling. Shame depends for its force on bosses internalizing the fact that their greedy behaviour is indeed shameful. One of the ways that this is driven home is by the use of example. Not every offending boss can be sanctioned, but once bosses see that their behaviour may lead to sanctions, they may behave with greater restraint. The very fact that Goodwin lost his gong will probably make others more wary of aping his conduct in future.

As to the spillover effect on friends and family, this is one of shame's deterrents. The desire to protect those close to you from public opprobrium and scorn acts as a powerful restraint on offending conduct.

In spite of the financial crisis and slump in stock market values, executive pay has continued to rise relative to average wages. A decade ago, the average FTSE100 boss earned 60 times the average wage. Now it is 185 times. Hard times do not appear to have led bosses yet to question the propriety of their demands. Unchecked, these threaten to undermine respect for capitalism in Britain and could ultimately pose a real threat to social stability. If this can be averted at the cost of a few bruised executive egos, it seems a price worth paying. ■

Annex
Biographies

Deborah Hargreaves
Founding director of the High Pay Centre. She is the former business editor of the Guardian. She previously worked at the Financial Times where she was news editor and before that, financial editor.

Simon Caulkin
A writer and editor who for 16 years was the Observer's management columnist. He has contributed to the Economist, the Financial Times, and many national and international business magazines. Simon has also worked on books with prominent business academics and leaders such as the late Sumantra Ghoshal, Andrew Campbell and John Seddon.

Paul Nowak
Head of the services department at the TUC since 2009, which is responsible for the TUC's regional councils, public services, organising and recruitment, health and safety and inter-union relations. Paul was one of the first intake of the TUC's 'organising academy' in 1998 and has been an active member of unions including the GMB, Unison and CWU.

Frances O'Grady
TUC General Secretary from September 2012, the first woman to hold this post. She had been deputy general secretary since 2003. Frances has been an active trade unionist and campaigner all her working life and previously worked for the Transport and General Workers' union.

Guy Opperman MP
Conservative party politician, who was elected at the 2010 general election as the MP for Hexham. Guy has an honours degree in law from the University of Buckingham and a first class diploma from the University of Lille, France. He was formerly a barrister at 3PB.

Caroline Lucas MP
MP for Brighton Pavilion and former leader of the Green Party of England & Wales. She is the UK's only Green MP. She is a passionate campaigner on the environment, social justice and human rights.

Ros Altmann
Director-General of the Saga Group. She is a pensions and economics policy expert and former investment banker, who has advised governments, corporations, trustees and the pensions industry.

Jonathan Ford
Chief leader writer at the FT since January 2010. He joined from Reuters where he was commentary editor and set up the company's first team covering financial comment. Before that, he worked for eight years at the financial commentary service Breakingviews, of which he was a co-founder. Jonathan started his career in investment banking.

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