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Why is modern capitalism irresponsible and what would make it more responsible?

A company law perspective

Andrew Johnston and Lorraine Talbot[1]

> '… the concept of capitalism refers to… a society that has made the amelioration of its collective living conditions and the realisation of its core value of personal freedom both dependent on and subservient to successful activation of the profit motive and the maximisation of the rate of increase of its capital'[2] (Streeck 2016)

Abstract

We claim that capitalism is inherently irresponsible precisely because production and distribution to meet the needs of society is subordinated to profit maximisation. Historically, the corporate form enhanced that irresponsibility by accommodating rentier shareholders – whose only concern is with the income generated by their shares – by limiting their liability and by treating the company in law as separate from shareholders and their property, the fungible and fully transferable share. We show how this irresponsibility was somewhat countered in the post war period by government policy and an empowered and active labour movement, but re-emerged in the late 1970s when the economy could no longer support both rentier and labour interests. Since then, company law has enabled various financialised methods of increasing shareholder returns at the cost of innovation, productivity and returns to labour. We recommend policies to reform the company by reducing rentier-driven irresponsibility, particularly in the form of executive remuneration. We argue that existing responsible company forms such as the

[1] Andrew Johnston is Professor of Company Law and Corporate Governance, School of Law, University of Sheffield, a Research Associate at the University of Cambridge Centre for Business Research and a member of the Sustainable Market Actors for Responsible Trade (SMART) Project (http://www.uio.no/smart), which is based at the University of Oslo. The SMART Project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 693642, whose support he gratefully acknowledges.

Lorraine Talbot is Professor of Company Law in Context at the University of Birmingham. She is a Co-ordinating Lead Author for the International Panel for Social Progress which has just completed a two-year project into the social progress issues relating to corporations, finance and markets. https://www.ipsp.org/ This paper was written with the support of the Leverhulme Trust over the course of a Fellowship to provide a critique of modern corporate capitalism and to set out such reforms that may make the company socially progressive.

We thank Ellen Stenslie for helpful discussions in relation to Community Interest Companies. All errors remain our own.

[2] W Streeck, *How Will Capitalism End?* (Verso 2016) 229

Community Interest Company cannot create a more responsible capitalism while the limited liability company continues to provide substantial benefits to the alliance between rentiers and executives.

Introduction

Milton Friedman famously proclaimed that 'a corporation's responsibility is to make as much money for the stockholders as possible.' From this we can surmise that, for Friedman, a responsible system of capitalism is one concerned only, or at least primarily, with profit maximisation. This is not the position we take here. We consider an economic system to be 'responsible' when it produces enough of the private goods people need to thrive, when it preserves enough of the public goods upon which all depend, and when it possesses mechanisms to distribute those goods equitably. Such a system is equipped to innovate and to meet future challenges. The question is: how do we get our economy to look like that? Like Streeck, we argue that the ability of a capitalist economy to operate responsibly is extremely limited, given that social goals are subordinated to the goal of profit maximisation. Without regulation and governance designed to ensure socially responsible outcomes, capitalism cannot be responsible because its driving force is profit, and it produces and innovates only to create more profit. Accordingly, capitalism only improves social and environmental conditions if this *accidently coincide*s with profit maximisation. As a result, capitalism tends to generate negative social outcomes, and it has long been recognised that society must intervene to prevent social costs and ensure social benefits; a Polanyian double movement[3] first evident in the political activities of workers and later embraced by reformers and government. This social taming of capitalism is, however, always a temporary fix because capitalism is a dynamic and changing social system prone to slip the noose of responsibility. Irresponsibility is endogenous to capitalism, and this tendency is particularly pronounced in modern, global corporate capitalism.

There remains, however, a dominant strand of thought amongst business scholars (broadly defined) that 'responsible capitalism' is a political choice; one that was made in all major economies in the post war period, until systematically abandoned by the US and UK from the 1980s, although continued (to varying degrees) in other economies. The varieties of capitalism literature typifies this reasoning as it attributes the creation of different kinds of capitalism to the

[3] K Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (first published 1944, Beacon Press 2001)

political choices of different states.[4] From this perspective, the German system of social democracy and codetermination is characterised as being the zenith of responsible capitalism, whilst neoliberal, financialised Anglo-American capitalism is its nadir.

This is an attractive position for reformers as it presents a clear blueprint to create a more responsible form of capitalism. It makes political choice the means to improve welfare outcomes and to address inequality and environmental damage. However, we believe that this position is ahistorical and decouples politics from the dynamics of capitalism, thereby avoiding the more radical implications of creating a new, non-capitalist society. We recognise that even the significant reforms we suggest would not deal with the problems inherent in our economic system, although they may soften some of the most egregious inequalities and irrationalities which arise from corporate activities as currently governed. We recognise it will be very difficult to 'responsibilise' modern British capitalism and the company, given that the myopic drive for short-term shareholder value is accompanied low corporate profitability and an inflated equities market. So, the scene is set for even greater levels of irresponsibility unless radical reforms are undertaken in all areas of our social and economic life. This piece focuses on radical reform of the company.

In taking this argument forward we begin by setting out a brief history of responsible capitalism and its (partial) demise. We then go on to examine how irresponsibility is integral to company law, examining the rise of outside and 'irresponsible' investors from the nineteenth century onwards and their role in establishing two key attributes of modern company law: separate corporate personality and limited liability. We examine how irresponsibility has been enhanced through company law, highlighting the increased focus on delivering shareholder value through mechanisms which have negative social and environmental impacts. We particularly focus on the governance mechanisms which have linked director rewards to shareholder value and strategies to advance both of these interests, such as share buybacks and increasing leverage. We argue that shareholder value-driven activities restrict long term investments in innovation, enable the 'super-exploitation' of foreign workers and harm the interests of domestic workers.

In this paper we have limited ourselves to considering the irresponsibility which is perpetuated by the shareholder primacy orientation of companies. Our argument throughout is that business is currently driven almost exclusively by the expansion of private wealth, and this trajectory

[4] P Hall and D Soskice (eds), *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage* (OUP 2001)

enhances irresponsibility in capitalism. Thus, in the final sections, we examine reforms which would redress the enabling of capitalist irresponsibility through the corporate form. Such reforms would provide some resistance to the destructive impulse of capitalism. We then critically consider a company form which provides an alternative to shareholder primacy in that it deprioritises profit maximisation, protects assets and encourages stakeholder governance: the Community Interest Company. We ask whether alternative business forms can really encourage an alternative and responsible form of capitalism.

II. *The Rise and Fall of Responsible Capitalism* : *A Short History*

Responsibility is not integral to capitalism. Rather, it is a quality that arose from accumulative social and political changes – not least the activities of collective labour – and from resistance to the socially irresponsible attributes of capitalism. Responsible capitalism was achieved through political determination and it was achieved in the context of high economic growth.

Thus, the notion that capitalism could and should be responsible is a relatively modern idea that only emerged in the post-war period. During the first half of the twentieth century, capitalism began to be strongly contested with the emergence of organised labour. As industrial unrest grew and the number of strikes increased, the emergent corporate managerial class claimed that it could balance the conflicting interests of labour and capital, a position endorsed by the UK government during the reconstruction programme which followed the first world war.[5] The first world war had damaged the authority of the ruling class and many disillusioned people in developed capitalist countries drew inspiration from the Russian revolution and its alternative to capitalism.[6] Viewing management as an intermediary between capital and labour, charged with developing 'esprit de corps' held out the prospect of deflecting this challenge to the status quo. Labour could be appeased within the broad managerial discretion that already existed within company law, and, as shareholders were becoming increasingly dispersed, they could neither resist this nor impose demands on the directors of companies. In 1926, Keynes referred to this

[5] Ministry of Reconstruction, *Scientific Business Management*, Reconstruction Problems 28, (HMSO 1919). For further discussion of the emergence of this balancing ideology, see A Johnston, 'The Shrinking Scope of CSR in UK Corporate Law' (2017) 74 *Washington and Lee Law Review* 1001, 1011-13.

[6] National Communist Parties were formed in a number of major countries from 1920 including the Communist Party of Great Britain. The earlier writing of Rosa Luxemberg (*Reform or Revolution and other Writings* (1900)) as well as the writings of Trotsky and Lenin had massive impact at this time.

emergence of 'semi-socialism' in 'semi-autonomous corporations' as a development which was probably preferable to control of industry through organs of central government.[7]

The Wall Street crash and the ensuing economic depression of the 1930s further polarised global politics, with the systems of Stalinist Russia at one extreme and fascist Germany at the other. In the period leading up to the second world war, the British ruling elite were coming to terms with the inevitability of a transition from capitalism to socialism, should fascism not prevail. The diaries of the Russian Ambassador, Ivan Maisky, remind us of the pervasive resignation of the ruling establishment to a socialist Britain.[8]

In the event, the British post war settlement saw the continuation of capitalism but with many radical changes and the expansion of social welfare; cradle to grave support for all, funded by taxes which were aimed at wealthier citizens and companies. The post war settlement between 'capital' and a labour force, which now viewed itself as both morally entitled and politically strong, involved the construction of social institutions to protect citizens from the acknowledged endogenous instability and irresponsibility of capitalism. It also removed essential industries, such as utilities, from the private sector in a massive nationalisation programme. The combined programme of social welfare and nationalisation of key industries became the compromise which sidestepped the widely-anticipated triumph of socialism.

These compromises made it appear that making capitalism more responsible was solely a matter of sufficient political will. However, the continuation of this compromise between labour and capital was only politically possible because of high growth in the post war period. High growth and profitability also enabled a relatively harmonious accommodation with the legally and politically empowered trade union movement, so that for an extended period, wages and job security improved substantially.[9] As Piketty shows, levels of inequality in society fell to unprecedented levels in the post war period. Measuring the ratio between income (all goods produced and distributed) and capital (all wealth which produces an income) to determine levels of inequality within society, Piketty's analysis shows that following World War II, high growth

[7] JM Keynes, 'The End of Laissez-Faire' (Hogarth Press 1926)

[8] G Gorodetsky, *The Maisky Diaries: Red Ambassador to the Court of St James's, 1932-1943* (Yale University Press 2015)

[9] L Talbot, 'Trying to Change the World with Company Law? Some Problems' (2016) 36 *Legal Studies* 513

levels led to a rise in income which resulted in a low ratio, indicative of reduced inequality.[10] This further helped with the rehabilitation of capitalism. It was now an economy that delivered wealth *and* equality.

While profits stayed reasonably high, capital owners tolerated the increasing claims of labour, and, indeed the political climate made it difficult to do otherwise. This changed in the late 1960s as profits fell[11] and capital owners became increasingly intolerant of labour's share, given their own reduced returns. At the same time, as we discuss in the next section, apparently technical reforms made to company law in the post war period enabled a resurgence of shareholder powers within companies, paving the way for the emergence of the hostile takeover and the (re)emergence of irresponsibility. Post-war responsible capitalism gave way to Friedman's notion that responsible business was one which maximized profit for shareholders. These neoliberal ideas found fertile ground in the context of a re-emergence of political conflict between trade unions and capital, with industrial unrest and strikes rife in the late 1960s and 1970s. The final flourish of social democratic governments in this period was an abortive move for industrial democracy, which proposed but never achieved employee-level board representation.[12] The state became increasingly pro-business, culminating in the accession to power of the New Right Conservatives, with their own brand of neoliberalism, in 1979. They gradually weakened and then broke the power of the unions, increasing the share of national product distributed to capital (in the form of shareholders and executives) at the expense of labour.[13] Industrial democracy fell off the agenda. The New Right deregulated finance, empowering financial markets and so providing further fuel, in the form of leverage, for hostile takeovers during the 1980s. The result was a stronger imperative to increase returns to shareholders, ideologically supported by pro-capital neoliberalism. Managers took advantage of globalisation to outsource many lower skilled jobs in search of cheap labour in developing countries, further reducing the

[10] T Piketty, *Capital in the Twenty-First Century* (Belknap 2014) 25-26 and 166-168

[11] M Roberts, *The Long Depression* (Haymarket Books 2016)

[12] The high point of this was the Bullock Report: see Department of Trade, *Report of the Committee of Inquiry on Industrial Democracy* (Cmnd 6706, 1977)

[13] So, while for much of the post war period labour in most developed countries claimed around 75% of the GNP, from 1980 labour share fell 0.3% each year so that by 2009 labour compensation of national income in the G20 countries had fallen to 61.7%: see OECD, 'The Labour Share in G20 Economies', Report prepared for the G20 Employment Working Group Antalya, Turkey, 26-27 February 2015 <https://www.oecd.org/g20/topics/employment-and-social-policy/The-Labour-Share-in-G20-Economies.pdf> accessed 8 May 2018

bargaining power of labour and its share of the national product. The resulting longer and more complex supply chains inevitably increased environmental irresponsibility, as the movement of components and products at various stages of completion massively increased global transportation.[14]

From the early 1980s, as we set out in the next section, encouraged by changes to the taxation regime and later by soft law measures, and under pressure from institutional investors, companies increasingly adopted US-style, shareholder value remuneration practices for their senior executives. In the name of aligning director and shareholder interests, labour compensation for the top percentile earners (executives and the professionals who provided financial engineering and other services) massively increased. As Milanovic's 'elephant' graph of global poverty shows, the incomes of the top 1% globally have risen 60% since 1988.[15]

Britain was the first European country to adopt a neoliberal program, while others, principally, France with its state-led capitalism, and Germany with its corporatist system, continued in a more social democratic direction. These divergences in political choice were viewed as resulting in a more responsible capitalism, although both approaches have come under pressure both from the constitutional structure of the European Union, with its insistence on free movement of capital and freedom of establishment; from declining profitability; and from the encroachment of pro-shareholder value practices. Capital can no longer afford corporatism. Even the strongest social democratic states have reduced their commitment to welfare and high labour share. The Hartz IV reforms[16] which radically reduced unemployment benefit in Germany, and various

[14] G Gereffi, 'Global value chains in a post-Washington Consensus world' (2014) 21(1) Review of International Political Economy 9

[15] C Lakner and B Milanovic, 'Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession' (2015) *The World Bank Economic Review* Advance Access published August 1, 21 (covering the period from 1988 to 2010)

[16] 'German labour-market reform: Hartz and minds', *The Economist*, (London, 29 December 2004), <http://www.economist.com/node/3522141> checked 8 May 2018. See also C Odendahl, 'The Hartz Myth: A Closer Look at Germany's Labour Market Reforms' (2017) Centre for European Policy Reform, <http://www.cer.eu/sites/default/files/pbrief_german_labour_19.7.17.pdf> checked 8 May 2018, 12 (Chart 11 showing trajectory of wages for different percentiles, with high wages continuing to grow, median wages stagnating and low wages falling, so that the intended wage restraint largely occurred in the bottom parts of the distribution) and 13 (discussing growth of outsourcing, and divide between insider TU members in core manufacturing and outsiders in service sector)

attempts to reduce labour rights in France[17] are just some examples of this universal drift to a less responsible capitalism.

III. How the Corporate Form Enhances Irresponsible Capitalism

The limited liability company is the legal vehicle through which most capitalist production, accumulation and distribution of wealth occurs. From at least the 1980s, the corporate vehicle became central to the emergence of a dramatically less responsible capitalism, underpinned by a predominant focus on creating shareholder value, with 'corporate social responsibility' relegated to voluntary concessions that were consistent with the primary goal of profit maximisation. The notion of the company as a social institution contributing to the public good, which was never particularly strong in the UK, was lost entirely during this period. Under the influence of the burgeoning law and economics literature, policymakers equated returns to shareholders with increasing social wealth, and high share prices with a healthy economy.

The company has many longstanding attributes, such as separate personality and limited liability, which ultimately enabled capital to reassert its interests over the claims of labour and citizens. However, the success of the corporate form in pursuing shareholders' (short term) interests also rested upon key changes to company law and corporate governance which had the explicit aim of prioritising shareholders' interest and curtailing the power of managers to take account of other interests.

In this section, we first examine the origins of separate corporate personality and limited liability showing how they are premised upon, and in the case of limited liability were demanded by, investors who are inherently irresponsible. We then examine more recent changes in company law and governance to show how policymakers came to interpret the interests of the company's shareholders as the sole goal of the company, to be pursued at the expense of other possible positive social outcomes.

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[17] A-S Chassany, 'Philippe pushes for rapid action on French labour reform', Financial Times (London, 6 July 2017 <https://www.ft.com/content/b5f42cf4-4ac4-11e7-919a-1e14ce4af89b?mhq5j=e1> checked 8 May 2018

i. Enabling Irresponsible Ownership - Separate legal personality and limited liability

The history of separate corporate personality and limited liability is pertinent to our discussion on irresponsibility because this is also the history of the rise and domination of the disconnected and irresponsible shareholder in whose interests the company is shaped. The history of the modern corporate form is the history of the rentier shareholder

The history of separate corporate personality is one largely made in the courts, which had to determine the legal consequences of the law's creation of a corporate entity. The courts' decisions reflected their commercial awareness and understanding of the needs of the emergent rentier shareholder. In contrast, the history of limited liability is one of different and competing interest groups, and ultimately of legislation. However, while separate corporate personality and limited liability have distinct origins, they are conceptually intertwined and both underpin corporate irresponsibility.

Registration of a business as a corporate entity was available as of right, albeit without limited liability, from the Companies Act 1844. This allowed for the long-term commitment of capital to the business,[18] as well as 'asset-partitioning' (shielding the company's assets from the creditors of its shareholders[19]), perpetual succession, the possibility of conferring benefits on employees and so on.[20] However, it took many decades before the company and its shareholders were formally and conceptually separated. The company only emerged gradually as an entity distinct from its shareholders. This change can be followed through shifting conceptions of the nature of the property of the company and the proprietary rights attaching to shares. Published in 1888, Williston's *Harvard Law Review* article argued that the separation of these two properties began with the case of *Bligh v Brent* in 1837 in which the long-standing understanding that shareholders were beneficiaries of the whole business was replaced by an assertion that their interests were as beneficial and legal owners of the *surplus* created by company assets, but not the assets themselves.[21] Over the following decades this became the general understanding of the

[18] M. Blair, 'Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century' (2003) 51 UCLA Law Review 387

[19] H Hansmann and R Kraakman, 'The Essential Role of Organizational Law' (2000) 110 Yale Law Journal 387

[20] E Manson, 'The Evolution of the Private Company' (1910) 26 LQR 10, 13

[21] S Williston, 'History of the law of business corporations before 1800: part II' (1888) 2(4) Harvard Law Review 149

proprietary rights attaching to shares. The courts' shifting view of these rights reflected the increasing lack of responsibility on the part of shareholders, who became less like entrepreneurial owners, expressing interest in the intricacies of the business, and more like rentiers, interested only in revenue.[22] As companies failed or merged in response to various crises, with 'big capital taking over small capital',[23] shareholders with a purely external relationships to companies became the norm.[24] By the end of the nineteenth century, the most accurate description of most shareholders was as owners of the revenue created by the company, but not the company itself, and who sought no involvement in the company's activities. They had become rentier capitalists. Once shareholders were fully externalised the company became capable of being a distinct and separate entity, with its own powers and interests.[25]

In contrast to the organic development of separate corporate personality, limited liability was introduced by legislation in 1855 as a result of a series of shifting alliances between different interest groups, and following considerable public controversy. But, like separate corporate personality, it was driven by the emerging rentier capitalist class. In the debate over limited liability the key conflict was between industrialists who had no need for limited liability because profits were high and risk was low, and pure investors, or rentiers, that 'body of capitalists not directly engaged in trade, who were now seeking an outlet, with profit, for their accumulations'.[26] The latter were 'the chief instigators of the limited liability legislation'.[27] They had been consolidated as a class through the development of railway companies, and 'decisive pressure for the immediate change of the law came from the narrowing of investment outlets in the fifties' as dividends from railways stagnated, as well as opposition to the risk of unlimited liability even for 'dormant partners', a risk made particularly salient by the wave of joint stock bank failures

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[22] K Marx, *Capital: A Critique of Political Economy, Volume III* (first published 1894, Foreign Languages Publishing House 1962) 427

[23] K Marx, *Capital: A Critical of Political Economy, Volume I* (first published 1867, Foreign Languages Publishing House 1954) 626

[24] L Talbot, *Progressive Corporate Governance for the 21st Century* (Routledge 2012), Chapter 2

[25] P Ireland, I Grigg-Spall and D Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14(1) Journal of Law and Society 149

[26] JB Jefferys, '*Trends in Business Organisation* in Great Britain since 1856' (unpublished Ph.D. thesis, University of London 1938) 34-41

[27] Jefferys, ibid

between 1846 and 1857.[28] These investors did not view themselves as partners or proprietors; rather they were content to sit back, sign proxy forms and receive dividends, preferring 'a remunerative investment rather than a part share'.[29] Hence arguments were made that limited liability would facilitate the loan of money at a fluctuating rate just as the abolition of usury had facilitated lending at a fixed rate, and would reduce the excessive lending which had occurred under a system of unlimited liability.

However, the rentiers' success in getting limited liability into legislation was not the same as persuading manufactures to adopt limited liability or to organise their business to welcome outside investors. There was no dash to incorporate, and even when manufacturers did adopt the company form, they used mechanisms such as high denomination shares with large amounts of uncalled capital to provide the security for creditors they would have enjoyed with unlimited liability.[30] Taylor explains this by reference to ethical rejections of limited liability and 'the almost universal belief in the inherent superiority of private over corporate enterprise'.[31] However, it is much more likely that manufacturing (and other industries such as mining) did not seek outside investors because they simply did not need the capital. Profits were high and businesses were labour- rather than capital-intensive. Instead, it was increasing production costs, profit falls and crises which eventually broke the self-contained nature of industrial capitalists and gave rentier capitalists the investment openings they had been looking for.[32] So with economic necessity aligned with legal opportunity, rentier shareholders, fully protected from company liabilities and possessing freely transferable shares, began to dominate from the end of the nineteenth century.

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[28] Jefferys ibid 47-8 and 50-1.

[29] Jefferys ibid 51. McQueen also emphasises that the 'moral' climate engendered by unlimited liability and favoured by industrialists had 'a considerable human cost amongst smaller entrepreneurs' who 'faced the ever-present threat of insolvency'. However, he argues that Jefferys is 'at best only partially correct' and points to 'the role of the government, or more particularly, the Board of Trade, in advancing the legislation as a panacea to capital flight and as an incentive to competition': R McQueen, *A Social History of Company Law* (Ashgate 2009) 98-106.

[30] JB Jefferys 'The Denomination and Character of Shares 1855-1885 (1946) 16 *Economic History Review* 45, 46.

[31] J Taylor, *Creating Capitalism: Joint Stock Enterprise in British Politics and Culture, 1800-1870* (Royal Historical Society Studies in History, Boydell & Brewer 2006) 17

[32] L Talbot, 'Legal Institutions: A Marxist-progressive Approach to the Modern Corporation' in T-H J Suny, L Chester, and C D'Ippoliti Sapienza (eds) *Routledge Handbook of Heterodox Economics: Theorising, Analyzing and Transforming Capitalism* (Routledge 2017)

Shareholders came to occupy a peculiar position. Treated in terms of liability in the same way as lenders, exposed to the insolvency of the separate entity only to the extent of their contribution, but treated as partners, just as the founding entrepreneurs had been under unlimited liability, when it came to questions of control.[33] 'Owners' without responsibility, but with some control rights, underpinned the emergence of modern capitalism. What was the significance of this for capitalism itself? Marx certainly thought it heralded a new period of destruction, division and inequality.[34] Progressives, such as Adolf Berle, believed that shareholders had lost their entitlements as owners since ownership necessarily entailed responsibility for the management of thing that was owned, and liability for any losses resulting from it.[35] Shareholders had lost this responsibility with the separation of ownership from control and limited liability. Berle and Means reasoned that the new irresponsibility of shareholders potentially enabled those in control (managers) to guide companies towards becoming quasi-public institutions, less orientated towards making profit and focused on the interests of the community.

That this would be the outcome of irresponsible ownership would depend on managers not aligning themselves with the interests of irresponsible shareholders and shareholders not becoming active and demanding. Neither happened.

ii. The Binding of Corporate Decision-making to Irresponsible Ownership - Shareholder Empowerment and Alignment of Management and Shareholder Interests

The drive for greater shareholder control over companies in law began in the 1940s and has continued apace, intensifying since the Global Financial Crisis.

Since the Cadbury Report, shareholder empowerment has been consistently advanced as the solution to the repeated crises caused by (shareholder value) corporate governance. Where

[33] In *Welton v. Saffery* [1897] AC 299 at 324, Lord Macnaghten, speaking of companies incorporated under the 1862 Act, stated 'These companies are the creature of statute, and by the statute to which they owe their being they must be bound in regard to shareholders as well as in regard to creditors in all matters coming within the conditions of the memorandum of association .... Shareholders are not partners for all purposes; they have not all the rights of partners; they have practically no voice in the management of the concern.'

[34] Marx, Volume III (n22) 430

[35] A Berle and G Means, *The Modern Corporation and Private Property* (Harcourt, Brace and World 1932)

corporate irresponsibility is admitted, it is ascribed to management, whilst shareholders, who are its primary beneficiaries, are assumed to inculcate a more long-term approach to management.[36] This remained the policy prescription in the aftermath of the Global Financial Crisis, despite widespread recognition that shareholders played a key role in driving more risk-taking on the part of banks.[37]

The decision to enhance the legal powers of shareholders was one of the key drivers of the irresponsible capitalism we witness today. Before 1947, and in line with their position as mere rentiers, shareholders had become peripheral, giving their proxies to the board and satisfied by regular dividends, [38] whilst the directors with broad management powers were strongly entrenched under the default articles (a 75% majority of shareholders was required to remove them), so they became self-perpetuating.[39] The deliberate reversal of this 'natural'[40] development began with the Cohen Committee's recommendation, introduced in the Companies Act 1947, that shareholders should be able to override the articles and remove any director by simple majority. When combined with the emergence of institutional investors, this led in short order to the emergence of the hostile takeover and the reorientation of corporate management towards an exclusive focus on increasing returns to shareholders. This shift received intellectual justification from mainstream economists, who had always insisted that firms should maximise profits for an economy to operate efficiently.[41] Following the lead of the Gower-led minority on

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[36] L Talbot, 'Why shareholders shouldn't vote: A Marxist-progressive critique of shareholder empowerment' (2013) 76 MLR 791

[37] *Report of the High Level Group on Financial Supervision in the EU*, Chaired by Jacques de Larosière, 25 February 2009, Brussels, para 24; *The Kay Review of UK Equity Markets and Long-term Decision Making: Final Report (*London 2012), 20 and 45; European Commission, 'Green Paper: Corporate governance in financial institutions and remuneration policies (Brussels, 2.6.2010, COM(2010) 284 final), 8; and Talbot (2013) (n36)

[38] Board of Trade, *Report of the Committee on Company Law Amendment* (Cmd 6659 1943), 9 and *Minutes of Evidence Taken Before the Company Law Amendment Committee* (HMSO 1943-1944), para 7071

[39] J Foreman-Peck and L Hannah, 'Extreme Divorce: The Managerial Revolution in UK Companies before 1914' (2012) 65(4) Economic History Review 1217; TW Guinnane, R Harris, NR Lamoreaux, 'Contractual Freedom and the Evolution of Corporate Control in Britain, 1862 to 1929' (2014) *NBER Working Paper* No 20481

[40] Keynes (n7)

[41] For an overview of these developments, see Johnston (n5) 1013-16

the 1962 Jenkins Committee,[42] economists argued that hostile takeovers were desirable because they moved resources into the hands of more efficient controllers and forced incumbent directors to increase share prices if they wanted to head off hostile takeovers; a market for corporate control.[43] The introduction of the City Code in 1968, preventing directors from taking action to defend against unwelcome bids, converted the hostile takeover from an apparently unintended consequence of law reform into a policy choice. Under constant threat of takeover, directors of listed companies began to adopt many of the practices of takeover bidders, such as selling off assets to distribute the proceeds to shareholders and increasing the dividend.[44] Distributions to shareholders steadily increased from at least the 1970s.[45] This in turn undermined the practice of 'retain and reinvest', through which companies had financed most of their growth in the first half of the twentieth century.[46]

The negative impact of takeovers on development and productivity was episodic because the takeover market is cyclical. There were periods, during the 1970s for example, when the threat of hostile takeover abated, reducing the pressure on executives to prioritise the shareholder interest. However, the election in 1979 of Margaret Thatcher's neoliberal government brought with it a new raft of policy measures that increased the prioritisation of shareholder interests. Encouraged by favourable tax provisions, companies began to pay their executives in ways which incentivised the further distribution of wealth to shareholders rather than its reinvestment in the company's

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[42] *Report of the Company Law Committee* (Cmnd 1749, 1962), 209

[43] See R Marris, 'A Model of the "Managerial" Enterprise' (1963) 77(2) Quarterly Journal of Economics 185; HG Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110

[44] For examples, see G Bull & A Vice, *Bid for Power* (3rd ed, Elek, 1961); JB Tabb, *Accountancy Aspects of the Takeover Bids in Britain 1945-1965* (Unpublished PhD Thesis, University of Sheffield, 1968)

[45] For dividends and buybacks in the US, see Chart 5 in A Haldane, 'Who owns a company?', speech given at the University of Edinburgh Corporate Finance Conference on Friday 22 May 2015, <https://www.bankofengland.co.uk/speech/2015/who-owns-a-company> checked 8 May 2018. Evidence in relation to the UK is harder to find, but Haldane comments that, after 1980, 'dividend payout ratios almost never fall', and that buybacks have consistently exceed equity issuance over the past decade. Looking further back, Bull and Vice show that the emergence of the takeover was accompanied by a 'slight but significant increase' in the percentage of payments of profits to shareholders between 1953 and 1956: see Bull and Vice (n44) at 21

[46] For the US practice from 1919 to 1947, see A Berle, *Power without Property* (Sidgwick & Jackson 1960), 30-44

business. Whilst fixed executive pay could always be deducted from profits, the Finance Act of 1984 created the concept of 'approved' share schemes', which were limited to four times fixed pay[47] and required a vesting period of between three and ten years. These approved schemes allowed listed companies to set the cost of the shares against corporation tax if the option related to already existing shares, and so shareholders were protected against dilution. Yet most of the schemes submitted to the Inland Revenue for approval involved the issue of new shares, which did not have to be recorded as an expense, and therefore protected corporate earnings.[48] A further advantage was that executive gains on exercise of the options were subject to capital gains tax,[49] which was lower than income tax,[50] and any tax liability only arose when the shares were sold, not at the time the option was exercised.[51] These tax changes resulted in a dramatic uptake of share option schemes among listed companies, so that by 1985, almost every company had one.[52]

Tax changes were not the only driver of the growth of share options and other 'high-powered incentives' such as so-called 'long-term incentive plans'. Guidelines issued by the Association of British Insurers between 1984 and 1999 were very influential. Whilst they limited options to four time emoluments, they came to be interpreted as an entitlement rather than a ceiling, and led to the institutionalisation of share options, even as the tax advantages for individual executives were gradually reduced by 1995.[53] In 1995, these corporate practices were endorsed by the Greenbury Committee, which recommended that remuneration should 'align the interests of directors and

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[47] Finance Act 1984, Schedule 10, paragraph 5(2)

[48] BGM Main, 'The rise and fall of executive share options in Britain' in J Carpenter and D Yermack (eds), *Executive Compensation and Shareholder Value* (Springer 1999), 84

[49] Finance Act 1984, s38

[50] At the time capital gains tax was 30% as opposed to income tax at 60%, although the rates were harmonised in 1988. See D Egginton, J Forker and J Grout, 'Executive and Employee Share Options: Taxation, Dilution and Disclosure' (1993) 23 *Accounting & Business Research* 363; BGM Main, 'A Review of Some Questions on Executive Pay', Paper presented at NYU/LSE Corporate Governance Conference, November 2004

[51] Main (1999) (n48), 84.

[52] Main, ibid, 85, figure 1

[53] Main (2004) (n50), 20; BGM Main, 'The ABI guidelines for share-based inventive schemes: setting the hurdle too high?' (2006) 36 *Accounting and Business Research* 191

shareholders in promoting the company's progress',[54] and encouraging the use of performance share plans, with shares awarded based on total shareholder return relative to comparator institutions.[55] Following this, there was a move away from share options to performance share plans, but the principle that executive pay should be linked to shareholder value, however measured, was well established, and widely accepted by both executives and institutional shareholders.

The growth of incentive pay has contributed to the emergence of enormous income inequalities across society. It has incentivised executives to engage in various forms of financial engineering in order to enhance the metrics on which their remuneration is based. For example, earnings are smoothed to ensure that profits beat the consensus of analysts,[56] and distributions only increase to keep share prices on an upwards trajectory and ensure that executives receive expected compensation, leading to Haldane's observation that payouts to shareholders have been a 'one way street' since 1980.[57] Efforts to tweak the remuneration regime in various iterations of the UK's Corporate Governance code, such as requiring a remuneration committee consisting of non-executive directors to set pay,[58] and even giving shareholders a binding 'say on pay' in 2013,[59] has done nothing to halt the dynamic of rising pay and short-term incentives. The latest proposal to require listed companies to publish the ratio of CEO pay to 'the average pay of their UK workforce', along with an explanatory narrative, as well as the creation of a new public

[54] *Directors' Remuneration: Report of a Study Group chaired by Sir Richard Greenbury* (Gee, 1995), paras 1.10 and 1.15

[55] ibid, paras 6.31 and 6.39.

[56] SJ Terry, 'The Macro Impact of Short-Termism', Boston University Working Paper, June 2017, 2-4.

[57] Haldane (n45) noting that since 1980 dividends have been a 'one way street'

[58] See *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee 1992), para 4.42. Among the many reasons for the failure of remuneration committees to solve the problem, we can note the ratcheting effect of disclosure of pay following Greenbury, as well as the fact that in 2014, 64 per cent of FTSE 100 remuneration committee members held a position on another company's board, so that 'nearly two thirds of the current membership of remuneration committees is drawn from the corporate world in which high and excessive pay are taken for granted' and whose own levels of pay are 'far in excess of the pay of ordinary workers within the same companies or across the economy as a whole': see TUC, 'A Culture of Excess: The pay of FTSE 100 remuneration committee members', February 2015

[59] Enterprise and Regulatory Reform Act 2013, s79(4) inserting s439A into Companies Act 2006, giving shareholders a binding vote on the Directors' Remuneration Policy every three years

register of companies where 20% or more of the shareholders have opposed executive pay resolutions seems unlikely to bring about significant change.[60] The reason for this is that, however empowered they are, shareholders are unlikely to put up significant resistance to pay arrangements that incentivise executives to maximise short-term shareholder returns.[61] Whilst there is no evidence of shareholders driving changes to pay practices or even mounting meaningful opposition to existing pay practices,[62] the belief persists that corporate governance can be reoriented towards more long-termism and greater sustainability by increasing shareholder empowerment.[63]

These changes in the incentives of company directors interacted with an important change to company law allowing companies to repurchase their shares, so that companies began to buy back large quantities of their shares as an alternative to dividends.

Before 1981, share repurchases were illegal on the basis that they offended against the legal prohibition on the company acquiring its own shares.[64] Buybacks of shares out of distributable profits were first permitted by the Companies Act 1981,[65] but dividends continued to form a much larger part of distributions to shareholders in UK listed companies, and buybacks were far

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[60] BEIS, *Corporate Governance Reform: The Government response to the green paper consultation*, (2017), 18-19

[61] Talbot 2013 (n36)

[62] A Johnston and P Morrow, 'Towards Long-termism in Corporate Governance: The Shareholder Rights Directive and Beyond' in S Vitols (ed), *Long-term Investment and the Sustainable Company: a Stakeholder Perspective* (ETUI 2015)

[63] See for example the Commission's proposal to revise the Shareholder Rights Directive to 'contribute to the long-term sustainability of EU companies' by increasing the quality and level of shareholder engagement and creating 'a better link between pay and performance': Explanatory Memorandum accompanying European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (COM/2014/0213 final). The enacted directive is Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (OJ L 132/1, 20.5.2017)

[64] *Trevor v Whitworth* (1887) 12 App Cas 409

[65] The reforms were presented to Parliament on the basis that they would be of value primarily to small companies, allowing them to raise outside capital without losing control of the family business: HC Deb 1 June 1981, vol 5 cols 646-730

less common than in the US, where the SEC made buybacks easier around the same time.[66] However, buybacks began to increase in the UK from 1987,[67] mostly concentrated in larger listed companies, at a time at which executive pay was increasingly very rapidly (presumably as executives exercised their options).[68] Between 1997 and 2007, buybacks accounted for almost one third of distributions to shareholders,[69] reaching a peak in 2006 and 2007, when UK listed companies repurchased £32.5bn and £29.4bn of shares, but declining considerably since the financial crisis of 2008.[70] Indeed, repurchases have occurred at such a scale that, apart from the three year period following the financial crisis, when companies needed to raise equity in order to pay down bank debt, net equity issuance by non-financial companies was generally negative between 2004 and 2014.[71] Short-term shareholders and executives have a shared love of buybacks. For short-term shareholders it offers tax advantages, whilst executives like them because, under current remuneration practices, they provide an immediate boost to the share price, allowing them to exercise options at favourable prices, and increase earnings per share, allowing them to meet performance criteria in LTIPs. In contrast, other uses of corporate earnings such as investments in innovation or productive capacity may only produce returns after the executive has moved on.[72] For short-term shareholders waiting for a buyback announcement or a takeover bid, long-term investments have even less attraction.

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[66] W Lazonick and M Mazzucato, 'The risk-reward nexus in the innovation-inequality relationship: who takes the risks? Who gets the rewards?' (2013) 22 *Industrial and Corporate Change* 1093, 1115-6

[67] W Rees, 'The Impact of Open Market Equity Repurchases on UK Equity Prices' (1996) 2 *European Journal of Finance* 353. Toms and Wright note that 'GEC was the first company to utilise the share buy-back provisions of the 1981 Companies Act, in order to start reducing its mountain of surplus cash': see S Toms and M Wright, 'Corporate Governance, Strategy and Structure in British Business History, 1950-2000' (2002) 44 *Business History* 91, 108.

[68] See Main (1999) (n48), 87, figure 2

[69] L Renneboog and G Trojanowski, 'Patterns in payout policy and payout channel choice' (2011) 35 *Journal of Banking and Finance* 1477

[70] Bank of England, 'Quarterly repayments of all currency shares by UK issuers total in sterling not seasonally adjusted' (CPQB34K – Quarterly)

[71] Haldane (n45), Chart 3

[72] J Plender, *Capitalism* (Biteback Publishing 2015), 509

iii. Some Outcomes of the Empowerment of Irresponsible Ownership: Barriers to Development and Innovation

Shareholder value driven corporate activity has a negative impact on research, innovation and productivity. This is a clear indicator of economic and social irresponsibility and a failure of capitalist fundamentals. Profit seeking was justified in Schumpeterian analysis as driving innovation and forcing out old technologies through 'creative destruction',[73] leading to prescriptions for an unregulated economy in which those dynamics could freely play out. However, today, profit seeking is more likely to be pursued by avoiding innovation and capital investment and by maintaining old technologies because low labour productivity can be offset by low domestic wages and super-exploited labour in global value chains.

Directors are cautious about undertaking long term investment because shareholders avoid companies with long term investment plans. Committed investment in R&D is considered too risky.[74] Shareholders make short-term commitments and want short-term rewards to match.[75] As institutional investors of various stripes have become more activist, executives have responded to shareholder preferences, with adverse consequences for wider society in the form of reduced R&D spending. The Financial Times reports that UK expenditure on R&D was 1.7% of GDP in 2015, with businesses spending around two thirds of the total. Investment in R&D has been stagnant for 15 years and far below levels in competitor European and Asian economies with Germany at 2.7%, China at 3.1% and South Korea at 4.3%.[76] The Deputy Governor of the Bank of England, Sir Jon Cunliffe noted that one reason for weak investment by UK companies since the financial crisis is weak demand; another reason is the lack of finance for productive investment, with banks primarily lending for mortgage financing, and one in five firms facing external financing constraints. However, nearly 70% of firms that reported underinvestment cited a lack of internal funds as an obstacle, with internally generated funds used to make

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[73] J Schumpeter, *Can Capitalism Survive?* (originally published 1947, Martino Publishing 2011), 23

[74] Talbot (2016) (n9), 520

[75] Average shareholding periods have fallen in the UK from around 6 years in 1950 to less than 6 months today: Haldane (n45), 11-12 and Chart 1.

[76] G Jackson, 'Proportion UK spends on R&D stagnant for 15 years, says CBI', *Financial Times*, (London, 22 March 2017) <https://www.ft.com/content/72ad9708-0d95-11e7-a88c-50ba212dce4d?mhq5j=e2> checked 8 May 2018. See also the Kay Review (n37), 16, fig 2, showing the UK lagging behind the US, France and Germany from 1992 to 2010, despite the fact that quoted companies are 'awash' with cash

distributions to shareholders and purchase financial assets, whilst 80% of 'publicly owned' firms 'agreed that financial market pressure for short-term returns to shareholders had been an obstacle to investment'.[77] This is important as R&D expenditures are overwhelmingly concentrated in a limited number of companies.[78] While non-financial pressures, including 'greater risk aversion and greater uncertainty about the economic environment',[79] clearly play a role in reducing levels of R&D, risk aversion can, at least in part, be attributed to patterns of executive remuneration which deter investments in long-term projects whose payoff is uncertain (and likely to occur after the executives – and the current shareholders – have moved on). The Bank of International Settlements attributes low R&D investment to the 'risky trinity' of 'unusually low productivity growth, unusually high debt levels, and unusually limited room for policy maneuver'.[80] It highlights the growth of 'zombie companies', those just about able to service their debts but with no ability to invest and progress.

Companies have increasingly used low interest debt to finance their balance sheets, to fund incentive pay and feed the takeover driven imperative to produce shareholder value. This has further undermined investment in future capabilities. Although debt has long been used for corporate financing,[81] companies, under pressure to increase shareholder value, now pay out

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[77] J Cunliffe, 'Are firms underinvesting – and if so why?', speech given at Greater Birmingham Chamber of Commerce, 8th February 2017, <http://www.bankofengland.co.uk/publications/Documents/speeches/2017/speech957.pdf> checked 8 May 2018, 6-9

[78] In 2009, among the 1000 UK companies that invest the most in R&D, the top 50 carried out 60% of the investment, and 100 accounted for 80%. R&D expenditures were overwhelmingly concentrated in listed and foreign-owned companies. However, the top 1000 companies in the UK had a R&D density of 1.7% of sales, compared with global R&D density of the top 1000 companies (overwhelmingly concentrated in the US, UK, France, Germany, Switzerland and Japan) of 3.6%. The R&D density of listed UK companies (1.4%) in the UK top 1000 was markedly lower than that of private companies (2.1%) and foreign-owned companies (2.7%): see BIS, *The 2010 R&D Scoreboard*, URN 10/31A, November 2010 <http://webarchive.nationalarchives.gov.uk/20101208170547/http://www.innovation.gov.uk/rd_scoreboard/downloads/2010_RD_Scoreboard_analysis.pdf> checked 8 May 2018

[79] Cunliffe (77), 9

[80] Bank for International Settlements, *Towards Resilient Growth*, BIS Annual Report, June 2017 <https://www.bis.org/publ/arpdf/ar2017e1.htm> checked 8 May 2018, 8

[81] Debentures secured by a floating charge were the preferred way of raising debt capital in the late nineteenth and early twentieth centuries. See e.g. E Manson, 'The Growth of the Debenture' (1897) 13 LQR 418; GA MacDonald, 'The Evolution of the Debenture' (1907) 23 LQR 195

accumulated reserves, whether held onshore or offshore to shareholders in the form of dividends and share buybacks, using bond issuance to replace those funds with debt on the balance sheet.[82] In the US, corporate debt levels are 30% higher than before the crisis and the $8.6 trillion of corporate debt constitutes 45.3% of GDP.[83]

Increasing leverage makes companies riskier, renders employment more perilous, and by eliminating free cash flow, starves companies of internally generated funds which they can invest in the business. Instead, internally generated funds are distributed to lenders and shareholders through loan repayments and share buybacks, and it is up to those investors to decide whether, and if so, where, to reinvest that money. A vicious circle is created by the combination of pressure to produce shareholder value, the risk of investment and falling returns on investment. Debt is a short-term solution to this, but in the medium to long-term merely renders companies unable to invest because they must use the funds they generate to pay debts. Debt servicing and more debt becomes the solution for all but the largest companies.

The lack of investment in innovation and productivity is offset by the use of 'super exploited' global labour. The scale of this practice is hard to estimate, given the difficulty in obtaining data about the extent of offshoring by UK companies.[84] The UK Modern Slavery Act 2015 imposes a 'Transparency in Supply Chains' obligation, requiring, from 2016, UK companies with a global turnover of over £36 million to make an annual statement on the due diligence they exercise in relation to the use of slave labour in their supply chains. However, this requirement has generated little more than general statements on the abhorrence of slavery, while slavery itself

[82] R Rieder, 'Winners and losers from share buybacks', *Financial Times* (London, 15 June 2015) <
https://www.ft.com/content/61509e02-0cf6-11e5-a83a-00144feabdc0> checked 8 May 2018. The leveraged recap approach, where borrowing and distribution to shareholders are announced at the same time can also be used by companies which have 'large cash balances "trapped" offshore' because it allows them to 'return the capital without having to repatriate the offshore funds': see JP Morgan, '"Leveraged recaps": unlocking hidden balance sheet value', Corporate Finance Advisory Brief, May 2013, <https://www.jpmorgan.com/jpmpdf/1320670225793.pdf> checked 8 May 2018

[83] M Roberts, 'The End of QE', 21st September 2017, <https://thenextrecession.wordpress.com/2017/09/21/the-end-of-qe/> checked 8 May 2018

[84] The OECD published research in 2007 relating to 2005, showing that only 3.4% of job losses in the UK (6,764 out of 200,706) were attributable to offshoring: see OECD, *Offshoring and employment: Trends and impacts* (2017) cited in H Görg, 'Globalization, offshoring and jobs' in M Bacchetta and M Jansen (eds), *Making Globalization Socially Sustainable* (WTO/ILO 2011), 30.

continues.[85] The ILO estimates that $150billion globally is generated from forced labour in value chains.[86] The amount generated from acute low pay and poor working conditions in global value chains is, of course, much greater, with global value chains making up 80% of global trade.[87]

As an increasing share of corporate surplus has been distributed by companies to their shareholders, wages have stagnated both domestically[88] and internationally.[89] In the UK, increasing numbers of employees are employed on zero hours contracts. There has been a fall in the number of full time employees as a proportion of total employment since 2008,[90] and 2.8% of those in employment (905,000 people) are reported to be on a zero hours contract.[91] The low rates of productivity reported by the Office of Fiscal Studies can be directly attributed to the actions of companies in delivering shareholder value throughout periods of falling profitability by the methods discussed. This directly impacts on wages and standard of living for most people; 'Real wages are due to be flat next year, and even in 2022–23 average earnings are due to be

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[85] See for example House of Lords and House of Commons, Joint Committee on Human Rights, *Human Rights and Business 2017: Promoting responsibility and ensuring accountability*, Sixth Report of Session 2016–17, HL Paper 153, HC 443, paras 92-105

[86] ILO, *Combating forced labour: A handbook for employers and business* (revised edition 2015)

[87] UNCTAD, *World Investment Report 2013: Global Value Chains and Development: Investment and Trade for Development*, 135

[88] V Romei, 'How wages fell in the UK while the economy grew', *Financial Times* (London, 2 March 2017) <https://www.ft.com/content/83e7e87e-fe64-11e6-96f8-3700c5664d30> checked 8 May 2018

[89] L Elliott, 'Up to 70% of people in developed countries "have seen incomes stagnate"', *The Guardian* (London, 14 July 2016), <https://www.theguardian.com/business/2016/jul/14/up-to-70-per-cent-people-developed-countries-seen-income-stagnate> checked 8 May 2018

[90] BEIS, *Good Work: The Taylor Review of Modern Working Practices*, July 2017, 23. The Taylor review does not discuss corporate governance explicitly, although it 'believes firmly that the tone for fair and decent work is set at the top of an organisation, reflecting the demands of shareholders and consumers and extending out into the workforce and the wider supply chain' and calls for greater transparency about structure of workforces so that shareholders and workers can take informed decisions (ibid 50). The assumption that shareholders ('company owners') will demand that employees receive better treatment as part of their 'wider responsibility towards the people who work for them' is entirely in line with the policy approach to corporate governance since the 1990s.

[91] ibid 25, noting that apparent increase since 2012 could be 'at least in part, due to an improved recognition of this type of contract'

below where they were in 2007–08. That implies a lost decade and a half of wage growth, an unprecedented period of stagnant earnings in the UK.'[92]

IV. How to Make Capitalism More Responsible: Reforming the company or using an existing alternative corporate form?

a. Making Capitalism More Responsible by Reforming the Company

According to the analysis and evidence presented thus far, the development of the modern company underpinned by separate legal personality and limited liability constituted shareholders as owners of a fungible property form which they buy, hold or sell to enhance their financial returns. Other tweaks to the legal and soft law regimes have further strengthened the position of shareholders. The ascendance of the shareholder as rentier is part of the historical development of capitalism. The doctrine of separate corporate personality evidences shareholders' severance from the company's assets, and their role as rentiers in the purest sense. However, the logic of separate corporate personality has not been fully implemented in the law, as shareholders retain important control rights which go beyond their interests as rentiers. These control rights may be appropriate for partners or entrepreneurs who are equipped to exercise control and to discharge the social responsibilities this entails. In contrast, giving control rights to rentiers substantially increases short-term, high risk corporate-decision making because rentiers have few incentives to use their control rights to promote the long-term development of the company and many incentives to use them to extract value in the short-term. Written across the board, rentier-driven short-termism undermines the innovative capacity and productivity of capitalism as well as giving rise to huge and varied social costs.

In order to achieve greater responsibility, control rights should be removed from shareholders, or least spread more widely around those who are affected by the company's activities. We accept that the law should protect shareholders' rights to dividends, their right to dispose of their property and their right to information which impacts on the value of their property. Similarly, their protection from the liabilities of the company should be retained, even in cases of personal

[92] T Pope 'It may just sound like a statistic, but productivity growth matters for all of us', Huffington Post (24 November 2017) <https://www.ifs.org.uk/publications/10191> checked 8 May 2018

injury.[93] Indeed, this is logical, given their position as rentiers who are not (and should not) be engaged in management decision-making and therefore are no more responsible for the fortunes of the company than its creditors.

As such, we propose that the rights of rentiers should be limited to those concerning their own property rights in four key areas: to information relating to the value of their shares; to free transferability; to declared dividends; and to limited liability.[94] This limitation would exclude shareholder control rights over the company as a whole, such as their right to remove the directors by simple majority under section 168 CA 2006, which is the ultimate source of their influence and control over directors and their decision-making. Along these lines, the International Panel for Social Progress, in its report on corporations and finance,[95] recently proposed that existing shareholder control rights over the company could be devolved to company stakeholders within a new stakeholder board. They recognise that shareholders require some forum in which to make their views known, but argue that shareholder views need to be balanced against those of other stakeholders to ensure articulation of the wider range of interests required for sound and balanced governance. They identify employees as being particularly important in ensuring that the company meets social goals and maintains a credible long-term investment strategy. Employees, they argue, have an intrinsic interest in the long-term development of the business because this affects the long-term stability of their employment. The Panel's proposal shares our identification of shareholder power with poor governance.

We also argue for a radical reduction of shareholder decision-making in relation to takeovers. This may seem contradictory given our argument that shareholder rights should be maintained in relation to transferability of shares. This makes it arguable that the powers given to shareholders in takeover regulation are defensible because they simply relate to the ability of shareholders to decide on the sale and transfer of their shares. However, shareholders' powers under takeover regulation in fact go much further than free transferability. Article 21 of the Takeover Code allows shareholders to decide whether the directors may take defensive measures against a

[93] Contrary to the position taken in H Hansmann and R Kraakmann, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) Yale Law Journal 1879

[94] As proposed by AA Berle in *The 20th Century Capitalist Revolution* (Harcourt, Brace and Company 1954), 24 and PF Drucker in *The New Society The Anatomy of the Industrial Order* (Windmill Press 1951), 320

[95] International Panel for Social Progress, 'Markets, finance and corporations: does capitalism have a future?' in *Social Progress for the 21st Century* (CUP, forthcoming 2018)

takeover, a decision they will take according to how it affects the value of their shares. This right, which we argue should be removed, goes beyond transfer rights which exist purely to protect the rentier arrangement by allowing trade in titles to revenue. It enables shareholders to interfere with the workings of the productive entity, from which they are fundamentally distinct, whilst management and employees, who are an integral part of the enterprise, have no such rights. Their purely rentier interests coupled with the absence of any fiduciary duty to the company means that their exercise of these powers is likely to be self-serving and destructive of the enterprise.

An end to Article 21 of the Takeover Code would give companies more, but not sufficient, scope to defend against takeovers, at least where detriment to the business or other stakeholders is likely. This would help resist irresponsible takeovers that are driven by short-term financial considerations. The UK is permitted to take such an approach under the EU Takeover Directive, and a number of EU Member States give companies some scope to defend unwelcome takeover. Indeed, discussion about changes to takeover regulation are currently under way in the Netherlands, much to the consternation of large shareholders.[96]

Yet, abolishing Article 21 would simply return the UK to the proper purposes rule, which is still fairly shareholder-centric.[97] Takeover regulation therefore requires a significant rebalancing of powers within the company, as well as the abolition of Article 21, in order to encourage socially responsible takeover activity. A representative stakeholder board, with powers over the takeover process and with duties to promote the success of the enterprise, could articulate the interests of those most affected by a proposed takeover, and would be more likely to ensure a responsible outcome to any negotiations.

More generally, a stakeholder board would provide a countervailing force to shareholder value imperatives, potentially influencing managerial discretion in the interests of wider society. Employees are a particularly important voice, having a far greater concern with the long-term

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[96] M Marriage, 'Fresh investor outcry over Dutch takeover curb plans', *Financial Times* (London 15 July 2017), <https://www.ft.com/content/53759dea-688a-11e7-9a66-93fb352ba1fe> checked 8 May 2018, noting proposals to allow the management and supervisory boards time to consider the implications of a proposed takeover for all stakeholders, extend the current soft law 180 day 'response time' to give directors more time to consider both takeovers and demands from activist shareholders, as well as other measures to allow friendly takeovers.

[97] For analysis, see A Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 CLJ 422

survival and development of the business than diversified shareholders with liquid portfolios. As McGaughey puts it, 'The ultimate investors should have a voice. But "investment of labour" in enterprise *always* justifies the vote.'[98] Employee interests are bound to the constant 'creative destruction' which is intrinsic to capitalism. Innovation in various forms has the potential to benefit society in a way that enhancing shareholder value through financial restructuring does not. It also exposes to employees to significant risk where they specialise in response to innovation, or otherwise make investments in firm-specific human capital. In contrast to employees, shareholders are intrinsically transitory and concerned with immediate returns. Employee representation on boards – whether on the suggested stakeholder board or through other forms of representation – would help shape a more responsible capitalism, provided they had sufficient, independent voice. It is regrettable that, no sooner had she made it, Theresa May backtracked on her promise to put employee representatives on boards.[99]

Finding mechanisms to reduce the control powers shareholders currently possess would be an important step towards making capitalism more responsible. First, it would reduce the direct exercise of those powers by shareholders in their own inherently short-term interests, and second it would relieve some of the pressure on directors to make decisions that prioritise shareholder interests. However, as noted above, much of the impetus behind director decision-making in the interests of shareholders is the integration of shareholder value into the various legal and governance mechanisms which operate to align companies' executive remuneration strategies with the short-term interests of shareholders. Accordingly, policies designed to enhance responsibility will need to forensically identify and remove this alignment. Prior to the introduction of these remuneration strategies, the separation of ownership (of shares) from control (exercised by directors and managers) was viewed as essential to the capacity of directors

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[98] E McGaughey, 'A Twelve Point Plan for Labour and A Manifesto for Labour Law' (2017) 46 ILJ 169, 177

[99] Theresa May stated that 'if I'm Prime Minister… we're going to have not just consumers represented on company boards, but employees as well', 'We can make Britain a country that works for everyone', speech given in Birmingham 11th July 2016 <http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for> checked 8 May 2018); Theresa May, Keynote Speech at Conservative Party Conference (5 October 2016) claiming that plans to put both consumer and worker representatives on boards would be published before the end of the year; Theresa May, Keynote Speech to Confederation of British Industry (21 November 2016) noting that 'While it is important that the voices of workers and consumers should be represented, I can categorically tell you that this is not about mandating works councils, or the direct appointment of workers or trade union representatives on boards…'

to exercise stewardship. The separation enabled them to exercise discretion in a fair, disinterested way in the interests of the company as a separate entity.[100] Realigning their interests with those of shareholders undermines their ability to serve the interests of the company and to act as company stewards. Director stewardship of the enterprise requires independence and directors should not be incentivised to advance the interests of any one particular company constituent.[101]

Regulation might prohibit incentives linked to the current share price, or cap pay by reference to fixed pay, as is now done in banks,[102] or to the average employee in the company or even the national average wage. A minimal and interim requirement could be to link executive pay to ESG factors. There are signs that this approach is becoming more widely accepted: the BEIS report recommended that 'companies make it their policy to align bonuses with broader corporate responsibilities and company objectives', such as 'customer service, safety, employment, or environmental issues'.[103] However, there is no sign of shareholders pressing for these types of changes to remuneration policies, and remuneration committees retain considerable discretion to design strategies under the baleful influence of remuneration consultants.

Hence, it may be necessary to go further and prohibit bonuses altogether, replacing them with a rate of fixed pay appropriate to the job. As the Kay Review noted, 'we might ask why it is necessary or appropriate to pay bonuses to the directors of large companies at all. Many people doing responsible and demanding jobs – cabinet ministers, judges, surgeons, research scientists – do not receive bonuses, and would be insulted by the suggestion that the prospect of bonuses would encourage them to perform their duties more conscientiously.'[104] However, executive bonuses are not intended to incentivise conscientiousness; they are, as we saw above, intended to encourage them to exercise their very broad legal discretion for the benefit of shareholders,

[100] L Talbot, 'Polanyi's Embeddedness and Shareholder Stewardship: A contextual analysis of current Anglo-American perspectives on Corporate Governance' (2011) 62 *Northern Ireland Legal Quarterly* 451

[101] B Segrestin and A Hatchuel, *Refonder l'entreprise* (Editions du Seuil et La République des Idées 2012)

[102] A Johnston, 'Preventing the Next Financial Crisis? Regulating Bankers' Pay in Europe' (2014) 41 *Journal of Law and Society* 6

[103] House of Commons, Business, Energy and Industrial Strategy Committee, *Corporate Governance*, Third Report of Session 2016-17, 30th March 2017, Recommendation 19 and para 86.

[104] Kay Review (n37) 77

rather than pursuing other social goals, as they are legally entitled to do. Thus, bonuses undermine conscientiousness, distort the exercise of discretion, and focus executives on the short-term financial interests of shareholders at the expense of the long-term interests of the company and its various stakeholders.

Reforms to executive pay and takeover regulation would in turn reduce the incentive to engage in share buybacks. Yet, it would be more effective still to prohibit share buy backs entirely. The prohibition on returning capital to shareholders by repurchasing their shares was, until the 1981 reforms, in place from late nineteenth century and set out most clearly in the case of *Trevor v Whitworth*, in which the House of Lords ruled that, even if permitted by the articles, buybacks would always be void as ultra vires without court sanction because they would be 'inconsistent with the very constitution of a joint stock company, with limited liability.'[105] Thus, even before the decision in *Salomon*, shareholder and company (even, as in this case, a family company) were distinct and separate. The company was a separate entity which used shareholders' capital to engage in productive activity, which also involved engagement with creditors and the public who were legally entitled to trust that, whilst capital might be lost in the course of trading, the capital stated in the memorandum would be used for trading, or to meet liabilities, and not returned to shareholders.

It was inherent in the very nature of a joint stock limited liability company that shareholders' investment could only be recuperated by selling their shares to another person. Shareholders could not claim back capital from the company because that undermined the position of creditors and the productive activities of the company. The same logic that distinguished company capital from shareholder assets also shielded shareholders from the company's liabilities. The law which protected their rights as rentiers similarly protected the company from shareholder claims to capital, enabling the productive entity to thrive and innovate. The (apparently unintended, but extensive) use made of the reforms to capital maintenance rules in 1981 has undermined this separation and inhibited the ability of productive entities to take risks. The nineteenth century insistence on this separation established a rule which enabled the company form to facilitate huge advances in productivity. It should be re-established.

The reforms we have discussed in this section are based on a common principle: the company, as the institution which most successfully distils capitalism's primary drive to profit maximise, should be made more responsible by being given greater autonomy from the demands of

[105] *Trevor v Whitworth* (1887) 12 App. Cas. 409, 416 and 436

shareholders and markets for profit maximisation. Essentially, companies should be less capitalist and more like productive social institutions that mediate the competing interests that are at stake.

b. Making Capitalism Responsible through an Alternative Corporate Form?

To conclude our proposals to make capitalism more responsible we take a detour into a business form that was established in 2004[106] by a Labour government with the aim of fostering productive social institutions and a degree of inclusive, responsible capitalism: The Community Interest Company (CIC). The CIC modifies the corporate form with the express intention of reducing the profit-maximising imperative to which standard limited liability companies are subject. We have argued that a reformed legal framework for the limited liability company would contribute towards a more responsible capitalism. In what follows, we ask whether the CIC, with its modified organisational structure and constitution, represents an already existing but more responsible alternative to the limited liability company. Beyond that, we evaluate the extent to which it has, in more than ten years of existence, encouraged responsible capitalism.

Our analysis thus far shows that to discourage irresponsible capitalism the legal form under which capitalism operates should have organisational mechanisms which limit the use of financialisation to drive profit maximisation. Company law should encourage investment and innovation and should internalise employee and stakeholder decision-making processes to bolster long term investment and to resist short term shareholder value strategies.

1. The features of the CIC

The Community Interest Company already possesses those organisational features. The CIC is a company designed to deliver capitalism, to be sure, but *stakeholder* capitalism which has a community purpose and in which most of its profits are reinvested. The CIC can deliver profits to members, but if they do, this is tempered by features such as a dividend cap and an asset lock. Stakeholder governance is enabled and encouraged. And because a CIC can be formed as any other registered company, public or private, limited by shares, guarantee or by guarantee and having share capital, it can apply to all sizes of business and all ownership structures. Any existing company may convert into a CIC and thereby adopt the modifications specified in the Act to facilitate its social/business hybrid nature.

[106] See Companies (Audit, Investigations and Community Enterprise) Act 2004

The CIC is formally committed to a social purpose and to activities which benefit the community. Whether its purpose is of sufficient benefit to the community is determined by a community interest test which is satisfied where the regulator concludes that a reasonable person might consider that its activities are being carried on for the benefit of the community,[107] or, where the regulations state that specific activities do, or do not, benefit the community.[108] This test goes some way to ensuring that the social purpose of a CIC cannot be unduly manipulated. In this way, it is significantly more effective than the objects clause of a standard company in the past, when social purpose clauses were routinely rejected by the courts as *ultra vires.* [109] Community purpose is also bolstered by the requirement that all CICs must submit an annual CIC report which shows how the community interest test has been met. The regulator has wide powers to ensure that CICs adhere to their public benefit commitments. Of the few complaints made to the regulator about CIC activity, the most common is failure to operate for a community purpose, which could indicate that the regulator is perceived as an effective monitor of this CIC attribute.[110]

If the CIC is limited by shares, the CIC modifications also impose a dividend cap. The cap requires that distributions of any kind to the company's members are limited or capped at the level set out in the regulations.[111] As discussed above, in a registered limited liability company, the directors' principal orientation is the enhancement of shareholder value, which has many negative or socially undesirable outcomes. Thus, by limiting dividends, the CIC regulations significantly curtail the incentives to profit maximise, while enhancing the probability of reinvestment in the business. The dividend cap is a potentially transformative feature.

Another important modification to the company form is the asset lock which directly prohibits asset transfers to members. Assets can be transferred to another asset-locked body which is specified in the CIC's articles of association, or another body with the consent of the Regulator;

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[107] Companies (Audit, Investigations and Community Enterprise Act 2004, s35(2). The Regulations state that it would not be for the benefit of the community if the activities only benefitted the company's members or their employees

[108] The Regulations exclude political activities as not being beneficial to the community

[109] *Re Lee, Behrens and Co Ltd* [1932] 2 Ch 46

[110] Regulator of Community Interest Companies, Annual Report 2016-17 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630211/cic-17-2community-interest-companies-annual-report-2016-2017.pdf> checked 8 May 2018, 12

[111] Companies (Audit, Investigations and Community Enterprise) Act 2004, s30

or otherwise if this is for the benefit of the community. Assets can be sold provided they are sold for full market value and the funds are retained by the company. This package of controls blocks many of the problems associated with the valuation of private companies' assets and the various ways those assets can be distributed to members – evidenced by the asset stripping at BHS and the huge dividends paid to the Green family when Arcadia group assets were revalued. It also inhibits share buyback schemes, as the dividend cap applies to all distributions to shareholders. The CIC asset lock, therefore, goes some way to protect the long-term viability of the business.

Responsibility for encouraging stakeholder governance and fostering community connections falls primarily to CICs themselves. However, the Regulator (and her office) play a significant role in supporting this by reporting case studies in publicly available annual reports which highlight benefits to the community from CIC activity and their different methods in engaging stakeholder involvement.

The legal form of the CIC therefore provides some useful attributes in the advancement of responsible capitalism. It provides some protection of the corporate assets, reduces the incentives to pursue shareholder value and requires the company to have a purpose beyond profit making, and which must be specifically identified as being in the interest of the community.

Equally, though, these attributes are undermined by broader market imperatives. For example, the efficacy of the dividend cap has been reduced since its initial introduction precisely because it was unattractive to investors. Initially the regulations allowed the company to distribute 35% of distributable profits in any year, provided that amount did not exceed 5% above the Bank of England's base rate for each paid up share. However, the Regulator has the authority to set a new share dividend cap, aggregate cap or interest cap, subject to the approval of the Secretary of State,[112] which has been exercised to downgrade the cap. Concern by the Regulator that the CIC was not performing its hybrid purpose of providing an alternative to the profit driven company, evidenced by the fact that less than one quarter of CICs were registered as limited by shares,[113]

[112] Companies (Audit, Investigations and Community Enterprise) Act 2004, 22(3). The Regulator may from time to time, with the approval of the Secretary of State, set a new share dividend cap, aggregate dividend cap, or interest cap

[113] BIS, Changes to the Dividend and Interest Caps for Community Interest Companies Community Interest Companies: Response to the CIC consultation on the dividend and interest caps, (CIC/13/1333, 2013)

led to a consultation report which found that most CICs disliked the complexity of the double limits and desired the possibility of offering higher distributions. Accordingly, the consultation report recommended that the maximum dividend per share be removed, retaining only the maximum aggregate of profit that can be declared as a dividend.[114] This partial inroad into the dividend cap to satisfy investors is just one indication that CICs might morph into shareholder value companies to remain competitive. But this is not isolated to CICs. The largest and arguably the best known and successful employee owned cooperative, the Mondragon Cooperative Group,[115] has also adopted corporate strategies in order to remain profitable. These have included reducing wages, introducing more wage labour (as opposed to owner workers) and off-shoring work to developing countries, in much the same way as global corporations.[116] This is discouraging for those who view alternative business forms as the panacea to irresponsible capitalism but is indicative of the overwhelming constraints on responsible capitalist organisations within global capitalism.

Furthermore, when establishing CICs, the government preferred to make their stakeholding attributes subject to a soft law approach. This is echoed in the current government's view that regulatory overview is effective but 'light touch'.[117] The regulator does not prescribe stakeholder engagement, although she does issue detailed guidance and engages in consultations with CICs in respect of the regulations in general.

2. How successful is the Community Interest Company Model?

While the CIC has been under a certain amount of pressure to become more market oriented, the question remains: has it been successful in making British capitalism more responsible?

<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264664/CIC-13-1333-community-interest-companies-response-on-the-cic-consultation.pdf> checked 8 May 2018, 3

[114] Ibid

[115] Since its establishment in the 1950s, the Mondragon Group has grown to over 100 co-operative groups with over 80,000 employees and an annual turnover of over £10 billion

[116] A Errsati, I Bretos and E Etxezarreta, 'What Do Mondragon Coopitalist Multinationals Look Like? The Rise and Fall of Fagor Electrodomésticos S. Coop. and its European Subsidiaries' (2016) 87 Annals of Public and Cooperative Economics 433

[117] Regulator of Community Interest Companies, *Annual Report 2016/17*, <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630211/cic-17-2community-interest-companies-annual-report-2016-2017.pdf> checked 8 May 2018

Advocates of the CIC point to its popularity, as over 13,000 CICs are currently registered and functioning.[118] However, the real test of its transformative ability is whether the CIC is making business more aware of social issues and capitalism more responsible. We argue that neither is evidenced. Instead, the growth of CICs has been driven by small local initiatives that have always been present in some form or another, combined with the later addition of large health organisations created following government policy to devolve parts of the NHS to semi-private organisations. In the first three years of the Act, only 1,621 were formed but by March 2012 there were 6,391 and the following year there were 7,670. The numbers have been increasing by around 1,500 a year until the latest figure of 13,055 in 2017.[119] This upward trajectory has occurred because the CIC became the ideal vehicle with which to devolve health services from the NHS.[120] In 2008 a policy called Transforming Community Services was launched with the aim of devolving more healthcare away from PCTs to 'the community'. This reduced the services that fell to the NHS and reduced the number of staff employed by the NHS.[121] A significant and rising percentage (up by 6.0 per cent in 2011/12) of the NHS budget goes to care in a community setting, and this is organised through CICs: 'the CIC is increasingly the standard structure for spin-outs from health, youth services, leisure and other public-sector areas, whose budgets can be tens of millions of pounds.'[122]

The percentage of CICs which are registered as companies with shares is another indication that the CIC has been unable to make significant inroads into the dominance of the shareholder value company. This has remained at a near constant less than 25%[123] (around 75% are limited by guarantee) and even those companies that do have shares rarely distribute dividends, despite the

[118] ibid

[119] Ibid

[120] Health based CICs together with those in education, sports and the arts, dominate in terms of number of CICs and the wealth of the sector: ibid, 6

[121] NM Jones and A Charlesworth, 'A review of NHS expenditure and labour productivity: The anatomy of health spending 2011/12' < https://www.nuffieldtrust.org.uk/research/the-anatomy-of-health-spending-2011-12-a-review-of-nhs-expenditure-and-labour-productivity> checked 8 May 2018

[122] S Burne James, 'Analysis: The rise and rise of community interest companies', 1 June 2015, <http://www.thirdsector.co.uk/analysis-rise-rise-community-interest-companies/governance/article/1348096> checked 8 May 2018

[123] Regulator of Community Interest Companies (n117), 14: 29% were limited by shares in 2016, rising slightly to 23.5% in 2017

relaxation of dividend cap rules noted above. This indicates that these legal forms are not transforming capitalism – 'doing good while doing well' – but are simply useful vehicles for state based activities (principally devolved from the NHS) and small community enterprises that previously used different legal forms.[124] Capitalist business would appear to be remaining with the legal form that allows profit maximisation, the limited liability company. Capitalism, therefore, remains firmly immune to responsible business forms.

Conclusion:

In this paper, we have demonstrated that irresponsibility within capitalism has intensified because, whilst companies are legally and factually distinct from their rentier shareholders, who have little interest in the long-term prosperity of the enterprise, those shareholders are treated as though they are owners. We showed that an economy oriented around the promotion of rentier shareholder interests is inherently irresponsible. However, we also showed that through the twentieth century, social responsibility in capitalism was fostered and supported by different combinations of management, by the state and by organised labour. We noted that, paradoxically, company law gave shareholders stronger control rights in the second half of the twentieth century. However, we showed that this did not have a significant impact on the social orientation of capitalism because of the dominance of social democracy. Indeed, it was not until the 1980s when the political shift toward free market individualism and shareholder interests that the impact of these legal changes became fully manifest.

While these political changes were underway, there was little discussion about responsible capitalism or the social responsibilities of business, with Friedman's ideological stance holding an iron grip over policymakers. However, from the late 1980s the notion that companies could demonstrate social responsibility without state intervention gained traction. We have not here discussed the many manifestations and implications of this voluntary form of social responsibility. However, it is important to note that its effect is to place responsibility for curtailing capitalist irresponsibility with companies themselves, rather with than a democratically

[124] Part of the reason why social entrepreneurs adopt the CIC form is that the structure comes with far less bureaucracy than, for example, charities. They also provide the entrepreneur with more freedom and control. Being a CIC also gives access to various sources of funding such as grants that are not available to regular limited companies. See E Stenslie, 'Chameleons by law; an institutional inquiry into the Community Interest Company in practice' (forthcoming)

accountable government, or through active representative unions. Modern corporate social responsibility allows companies to define the scope of their responsibility and, by conducting PR campaigns, to manage the extent to which governments interfere in their activities.

We have outlined the ways in which modern shareholder value-driven corporate capitalism was enabled by the way companies are regulated and governed. In particular, we noted that it is driven by a strategic alignment of shareholder and director interests which has skewed corporate decision-making in directions which inhibit innovation, reduce productivity and decrease labour's claim on national product. We then concluded by canvassing a number of reforms which would reduce corporate irresponsibility and examined an already existing company form, the CIC, which specifically inhibits these tendencies and considered how far the CIC has positively impacted on business. It seems clear from the evidence that the CIC has not encouraged business to take a less shareholder value orientation. The availability of an alternative company form cannot alter the trajectory of capitalism per se. Instead the CIC has begun to adopt a more investor friendly regime. Its main use has been to accommodate the semi-privatization of the NHS, a further retreat from the welfare society.

As Streeck argues, capitalism makes all social goals subservient to the goal of profit maximisation. To alter that trajectory requires mandatory changes to the company form so that capitalism is forced by law to be more responsible. The current limited liability company enables both shareholders and directors to maximise their self-interest, and this is not something that either group will relinquish voluntarily. Similarly, companies will only rarely respond to reputational or other social concerns by voluntarily changing their behaviour in a more socially responsible direction.

There are, of course, limits to how much difference company law reform can make to the reduction of irresponsibility in capitalism. It is widely known that UK-based multinational corporate groups, like their counterparts elsewhere in the world, engage in aggressive tax planning, facilitated by multinational accountancy firms, using legal devices like transfers of intangibles and borrowing to ensure that profits arise in low-tax jurisdictions.[125] Moreover, the problem of corporate lobbying makes the process of law reform itself an arduous process.

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[125] OECD, *Making Globalisation Work: Better Lives for All*, Key Issues Paper, Meeting of the OECD Council at Ministerial Level, Paris, 7-8 June 2017, 24: 'Discontent has been expressed about the use of tax-advantageous jurisdictions by corporations to avoid taxes or shift profits and wealthy individuals to avoid or evade tax, preferential tax deals for particular companies and special arrangements for foreign investors to settle disputes, among other things.'

As a final observation, a responsible economy is one which distributes wealth fairly, produces the private goods people need to thrive, and preserves enough of the public goods upon which all depend. The reforms we suggest in this article would certainly reduce the pressure for short-term shareholder value and this may lead executives to distribute more corporate surplus to employees. Equally, it may not. To ensure fairer distribution, employees must act collectively to press their claims for higher wages. Absent the pull from labour, any push from management will not necessarily be toward increasing labour benefits. There are, of course, considerable challenges facing trade unions. Trade union membership is in severe decline, with less than 6 percent of the private sector and 12 per cent of public sector workers being union members.[126] The radical changes to the laws on collective action from the 1980s have greatly diminished unions' ability to take effective industrial action, while subsequent governments have continued the legislative diminishing of union power.[127] The recent Trade Union Act 2016 introduces a number a new hurdles to industrial action. This includes the requirement that at least 50% of those members entitled to vote in a ballot should do so, and of those voting, a majority must have voted in favour before industrial action can take place[128] – a provision which meant a number of UCU members did not take part in the 2018 industrial action over pensions, in spite of huge support across the sector.[129] The orientation of work away from traditional structures including the

[126] BEIS, *Trade Union Membership 2016: Statistical Bulletin*, May 2017, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/616966/trade-union-membership-statistical-bulletin-2016-rev.pdf checked 8 May 2018, 5-7 shows that trade union membership in the UK peaked in 1979 and, broadly speaking, has been declining ever since from more than 13m members in 1979 to just above 6.2m in 2016. The *OECD Employment Outlook 2017*, < http://www.oecd.org/els/oecd-employment-outlook-19991266.htm> checked 8 May 2018, figure 4.2, shows a similar trend in other English-speaking and firm-level bargaining countries, whilst density is much higher and more stable in Nordic and 'Ghent system' countries, but declining in Northern and Central European countries (Austria, Germany, Luxembourg, Switzerland, Netherlands. In the UK, trade union density is far higher in the public sector than the private sector (ibid, figure 4.A.1.6), and far higher in public administration and social and personal services than in the good-producing and business services sectors (ibid, figure 4.A.1.5)

[127] J Elgar and R Simpson, 'The impact of the law on industrial disputes in the 1980s' (1992) Centre for Economic Performance, < https://econpapers.repec.org/paper/cepcepdps/dp0104.htm> checked 8 May 2018

[128] Trade Union Act 2016, s2

[129] University College Union, USS Industrial Action Ballot, Final Report, 19 January 2018, <https://www.ucu.org.uk/media/9091/USS-ballot-results---ranked-summary-table/pdf/uss_ballotresults_summaryranked_jan18.pdf> checked 8 May 2018

growth of temporary work,[130] and the growing gig economy has made traditional forms of collective organisation more difficult. Indeed, some leading scholars in the field argue that changing work practices have effectively rendered collective action defunct.[131]

Underpinning the legal and political structures which contain capitalism is the state of the economy itself. In the introduction, we noted that the period of high growth and profitability in the post war period allowed for a compromise between labour and capital in which labour claimed a higher percentage of GDP. However, when growth began to fall in the 1960s, leading to lower profits and industrial conflict by the 1970s, governments eventually had to choose between reducing labour rights and therefore labour's claim on the surplus, or accepting lower returns for capital. They chose to champion capital, or, as they claimed, to protect business. By reducing labour share, making use of cheap international labour and increasing irresponsibility, capital was able to recover and thrive for the best part of three decades, at least until the global financial crisis. Company law and theory has been complicit in this. However, the continued post-GFC reliance on cheap flexible labour, financialisation and diminished investment not only creates a more irresponsible capitalism, it creates a capitalism that defeats its own logic and denies its own creative destruction. In terms of productivity, global capitalism is in a state of terminal decline. According to the IMF, 'The drop in total factor productivity (TFP) growth following the global financial crisis has been widespread and persistent across advanced, emerging, and low-income countries. And that decline—alongside weak investment in the case of advanced economies—has been the main contributor to output losses relative to pre-crisis

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[130] OECD Employment Outlook 2017 (n126), 128 notes that collective bargaining systems have been under pressure from technological and organisational changes, globalisation, the decline of manufacturing, flexible work, population ageing, policy changes, declining union membership and increasing individualisation of employment relationships.

[131] KVW Stone 'Legal Protections for Atypical Employees: Employment Law for Workers without Workplaces and Employees without Employers' (2006) 27 Berkeley Journal of Employment and Labor Law; KVW Stone, 'Flexibilisation, Globalisation and Privatisation: Three Challenges to Labor Rights in Our Time' (2006) 44 Osgoode Hall Journal 77

trends.'[132] Despite a succession of more optimistic forecasts, the OBR recently reported near zero productivity growth in the UK economy for the last five years.[133]

Any change in political will or any legal reform to effect responsibility will have to be made in the context of the slow growth, low productivity national and global economy. Hence, a responsible capitalism will have to be a much less profitable capitalism. Responsible capitalism is no longer a win-win choice. And, while company law reform remains central to the rehabilitation of capitalism to a state of responsibility, it is but one tear in the seamless web.

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[132] G Adler, R Duval, D Furceri, S Kiliç Çelik, K Koloskova, and M Poplawski-Ribeiro, 'Gone with the Headwinds: Global Productivity', IMF Staff Discussion Notes No 17/04, April 2017 <https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2017/04/03/Gone-with-the-Headwinds-Global-Productivity-44758> checked 8 May 2018

[133] Office for Budget Responsibility, *Forecast evaluation report*, October 2017, 6, referring to a 'hiatus in productivity growth [that] has now lasted for almost a decade': <http://obr.uk/fer/forecast-evaluation-report-october-2017/> checked 8 May 2018