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Capitalism recoupled

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Abstract This paper examines major forces that have decoupled economic and business prosperity from social prosperity and explores how recoupling can be promoted. Economists have specified well-known conditions under which free market enterprise with shareholder value maximization is efficient. These conditions are systematically violated by three forces—globalization, technological advance, and financialization (GTF)—that have weakened the connections between economies and societies over the past four decades. Consequently, the recoupling process requires abandoning the default premise of economic decision-making that social progress follows financial performance. For business, it calls for a move from shareholder to stakeholder value. For government, it calls for setting legal obligations, targets, and incentives to ensure that stakeholder value is compatible with a rigorously defined concept of 'societal and planetary value'.

Keywords: globalization, technology, financialization, shareholder value, stakeholder value, efficiency, social prosperity, wellbeing

JEL classification: A12, A13, D01, D21, D23, D31, D61, D62, D63, D78, H11

I. Introduction

This article starts from a simple premise: the purpose of an economy and therefore of business is ultimately to deliver progress for society, enhancing the wellbeing of individuals in thriving communities. This should be an obvious point of departure. After all, businesses—like the economies in which they operate—are human constructs, and human constructs should serve human purposes. In current practice, however, it is often far from obvious, due to the doctrine of the 'Invisible Hand', whereby the business pursuit of profit and shareholder value is assumed to lead to desirable social outcomes. Indeed, under well-defined 'Invisible Hand conditions', this is the case (at least in terms of efficiency). Then it is admissible to follow the Friedmanite maxim, 'The business of business is business.' What has received far less attention is that the Invisible Hand conditions have been systematically undermined over the past four decades by a nexus of three forces: globalization, technological advance, and financialization.

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These forces—the 'GTF nexus'—have changed the operating environment of business and therefore of economies. While this nexus has generated vast aggregate wealth and lifted billions of people out of poverty, it has also weakened the connections between economies and societies. With the proliferation of flexible global supply chains, business activities became less firmly rooted in local communities. This led to a loss of social cohesion. Furthermore, as the competition for jobs—and indeed for tasks within jobs—became increasingly global, having established skills and working hard were no longer sufficient to ensure job security at respectable wages. One could now lose one's job to people or machines in other parts of the world. This led to a sense of disempowerment.

To explore how these developments have decoupled business prosperity from societal prosperity, we begin by considering the conditions under which Adam Smith's Invisible Hand mechanism works, so that people pursuing their individualistic economic ends are led (as if by an Invisible Hand) to serve the public interest. In particular, economic analysis has identified five Invisible Hand conditions under which free enterprise promotes economic efficiency (enabling consumer wants to be satisfied at minimal resource cost): (i) perfect competition, (ii) symmetric information, (iii) diminishing returns to scale and scope, (iv) clearing markets, and (v) no externalities. Beyond that, the achievement of economic equity generally requires some redistribution of resources.

It is remarkable that the GTF nexus leads to the violation of all these conditions. In particular, the nexus has generated concentrations of market power, asymmetries of information favouring producers over consumers, rising economies of scale and scope facilitated by large digital networks, growing threats of technological unemployment and under-skilling, as well as rising social and environmental externalities of business activity. These dysfunctions—with special emphasis on the social and environmental externalities—underlie the current crisis of capitalism.

The default premise of decision-making by businesspeople and policy-makers has been that social progress follows financial performance. The primacy of the financial is reflected in the measurement of success: business success is measured primarily in terms of shareholder value and economic performance primarily in terms of GDP. The reporting, governance, and incentive frameworks for business ensure that decision-making remains focused on the financial. Criteria for public investment and government procurement and economic policy-making in general also have this focus. Education and training systems, welfare systems, and even social norms governing social relations are increasingly shaped by financial motives and goals.

In the process, business success—along with economic success more generally—appears to have become progressively decoupled from human flourishing. Climate change, biodiversity loss, and other environmental problems are proliferating, driven significantly by economic activities. Many societies are becoming increasingly fragmented, as witnessed by the rising tides of nationalist populism, ethnic tensions, and declining trust in economic, political, and social institutions. This development is related to economic activities through the growing inequalities of income and wealth, particularly within countries. Economic success is no longer seen to be a guarantor of wellbeing for sizeable segments of society and for much of the natural world.

To drive change in favour of addressing the recoupling challenge, we argue that it is necessary to shift the focus of business attention beyond shareholder value towards

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'stakeholder value' and beyond that to 'societal value'. Similarly, the focus of policy must shift from just economic value to societal value.

The traditional division of responsibilities in capitalist economies—with business pursuing profit, consumers maximizing their utility, and government setting the rules of play—is obsolete. We argue that, under 'capitalism recoupled', governments have an important role to play in shaping an appropriate operative business environment by setting the responsibilities of business in accord with the public interest, setting targets and requirements on all businesses, and influencing specific business activities through government policies. Civil society also has an important role to play through the social norms and values of business stakeholders.

This article is organized as follows. First, we show how the globalization–technology–financialization nexus has weakened the connections between economies and societies. Second, we show that this nexus leads to the violation of all the conditions under which free economic enterprise promotes economic efficiency. This helps explain the current crisis of capitalism. Third, we show that since the current default premise of economic decision-making is that social progress follows financial performance, recoupling requires that the focus on decision-making shifts to 'societal value'. Under 'capitalism recoupled', government and civil society have important roles to play in shaping an operative business environment that enables business to pursue societal value while pursuing profit goals within its social and environmental responsibilities.

II. The globalization–technology–financialization (GTF) nexus

The current stage in the evolution of capitalism has run into severe social, environmental, and political problems. There are widespread and justified concerns about fairness, social inclusion, inequality of income and wealth, and access to basic human opportunities in many developed and developing countries. To make matters worse, our politics have become more fractious both within and between countries. The earth's climate systems are becoming destabilized. 'Business as usual' in capitalist systems has become unsustainable. There appear to be no automatic stabilizers in these systems to address the growing social, political, and environmental problems.

It has not always been thus. In the first four decades following the Second World War, the default assumption in both developed and many developing countries was that economic growth would deliver societal progress. The reason was that economic progress would generate not just higher aggregate income, but also enable governments to provide public goods such as better health services, education and training, and welfare services. Furthermore, economic growth would permit redistributive policies to benefit the disadvantaged without reducing the living standards of the advantaged. Thereby economic growth could empower all population groups to shape their prospects through their own efforts and combine social cohesion with ever-improving living standards. By and large this dynamic has been reflected in outcomes over the decades—when economic activity stagnated, so too did conditions for society, and vice versa. Few would argue that the system was perfect, but the default assumption of social progress

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following economic growth continued to pervade and deepen in economic and business thinking: 'It's the economy, stupid'; 'The business of business is business'; and so on.

This dynamic appears to have begun to stall in the 1990s through the GTF nexus.[1] Globalization provided access to new markets at a scale not previously seen. Facilitated by enormous shifts in mindset and in the political and economic dynamic which followed the fall of the Berlin Wall and the opening up of China, the communications revolution and the birth of the internet also enabled truly global business models—businesses could not only access markets on a global basis, they could organize their operating models on a disaggregated but hyper-connected basis for the first time—the truly global supply chain. Financialization—characterized by the globalization of finance and capital markets and the use of financial metrics to measure the success of business and the economy—turbocharged access to capital, the globalization process, and the accompanying technological advances.

The GTF nexus created an entirely new operating environment for businesses, consumers, and governments. It weakened the geographic roots of companies. Multinational companies became able to shift activities and assets (especially intangible assets) flexibly across geographic locations to drive changes in profitability. In this process, companies also lost the long-term social bonds that they had traditionally established with their local communities. In short, the ties of mutual obligation between business and society—the social glue that traditionally helped ensure that business prosperity was closely linked to social prosperity—became frayed.[2]

The GTF nexus also weakened the connection between work effort and job and income security at the local level. Increasingly, job and income security became linked to the comparable performance of workers in remote parts of the world, or to the impact of increasing automation—or both. This experience was profoundly disempowering. We are at considerable risk of a new wave of automation, disruption, and disempowerment.

The specific implications for different stakeholder groups became obvious over time. The social effects of business activity fell increasingly outside the domain of the firms' immediate stakeholders, originally defined as the 'groups without whose support the organization would cease to exist' (Freeman and Reed, 1983). Regional disparities in income and wealth, as well as job opportunities and skills, that arose through the GTF nexus are a good example of third-party effects of business falling beyond these direct business stakeholders.

We also see profound debates now under way about the effective operation of certain markets and the related social and political implications which follow, especially in the digital sphere—a sphere which was not even contemplated when many of the assumptions about markets and economies were established. These include debates about market concentration, impact on inequalities and wealth, asymmetries of information between customers and providers, opportunities to influence and shape preferences of every kind, and data privacy.

[1] The workings of this nexus are explained in Kelly and Sheppard (2017).

[2] The GTF nexus also contributed to government failures. Globalization has allowed for superstar firms to earn economic rents, which can be spent on lobbying governments.

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It should not be surprising in light of this overall dynamic that we see a weakening of firms' ties to all of their stakeholders—employees, customers, suppliers, and local communities—and to the environment. In a competitive market system, with financial performance as both the dominant decision factor and the primary responsibility as owed to shareholders, combined with business models now operating with truly global scale and reach, the search for competitive advantage meant that other considerations would be secondary.

Citizens and communities that could not compete on these terms were left behind, both regionally within countries and indeed between countries. Planetary boundaries are incapable of supporting consumption levels. The wellbeing of citizens, communities, and the planet are not ignored—but they are secondary to the priority of financial performance in the hierarchy of factors which drive business and economic decision-making.

In these various ways, economic and business prosperity became progressively decoupled from social prosperity.

III. When the Invisible Hand works and when it doesn't

Many business leaders recognize the seriousness of the environmental and social problems generated by the current variant of capitalism but find themselves trapped in the systemic standoff described above. In order to investigate how the GTF nexus in combination with this standoff has decoupled business prosperity from societal prosperity, let us first consider the conditions under which the Invisible Hand works. Economic analysis distinguishes between efficiency and equity. As noted, there are five main conditions under which free market activity is Pareto efficient (so that it becomes impossible to make one person better off without making another worse off): (i) perfect competition, (ii) symmetric information, (iii) diminishing returns to scale and scope, (iv) clearing markets, and (v) no externalities. These conditions are so important that they deserve a name: we will call them the 'Invisible Hand conditions.'

Intuitively, the buyers who are active in each market are those who value the good most highly and the sellers who are active in each market are those who value the good least. The price in each market ensures that trades proceed until the good's value to the marginal buyer is equal to that of the marginal seller. If any further transaction took place, then either the marginal buyer would have to pay more or the marginal seller would have to accept less. Thus, the trading activities exhaust all the opportunities for improving anyone's standard of living at no one's expense. This is the sense in which the pursuit of individual gain is in the public interest.

Economic analysis views equity as a distributional issue, whose objectives (depicted in terms of a social welfare function) should be in the hands of elected politicians. The job of economists is restricted to finding efficient means for achieving the desired distribution of income and wealth. The social problems of social estrangement and disempowerment resulting from the GTF nexus do not fit into this distributional frame. They are better understood as social externalities, much as climate change and biodiversity loss may be understood as environmental externalities.

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What is truly striking—astonishing, at first sight—is that the GTF nexus has led to profound violations of all five conditions for the efficiency of free markets, and has been associated with rising inequalities of income and wealth. In short, the GTF nexus has unambiguously undermined the workings of the Invisible Hand.

There is ample empirical evidence (for example, Autor *et al.* (2020)) that this nexus has been accompanied by significant concentrations of market power, including the rise of 'superstar firms' ('winner-take-all' companies)—a violation of the perfect competition assumption.

The GTF nexus—particularly with regard to digital platforms, big data, artificial intelligence (AI), and automation—has given producers a material informational advantage over most consumers. Consumers have comparatively little information about the environmental and social effects of producing the products that they consume. This is a violation of the symmetric information assumption.

The GTF nexus has also generated huge economies of scale, network externalities (implying that the value of a digital network rises disproportionately with the size of the network), economies of scope from platform externalities (from matching customers with complementary needs), economies of information from big data and machine learning, and locational economies leading to clusters—a violation of the diminishing returns assumption.

The rapid advances in AI and robotics have created the much discussed danger that machines will take over routine work at a faster rate than people are able to reskill. This danger worries many routine workers who are currently employed,[3] and these worries have intensified in response to evidence that machines and AI are taking over jobs that have been lost during the pandemic.[4] Technological unemployment is a violation of the market-clearing assumption.

Finally, as noted, the GTF nexus has created massive social externalities by weakening the geographic roots of companies and thereby loosening the social bonds to the local communities. We have also seen how the combination of automation and flexible global supply chains weakened the link between work effort and job security, giving workers a profound sense of disempowerment. Furthermore, the rising concentration of market power has come with rising disparities of income and wealth, particularly within countries. These social externalities—in the form of falling social solidarity, falling empowerment, and rising inequality—have been measured systematically and are on the rise (see Lima de Miranda and Snower (2020)). Meanwhile, a host of environmental externalities—including climate change, ocean acidification, erosion of topsoil, decline of fresh water access, and loss of biodiversity—have been on the rise as well.

Of all these violations of the Invisible Hand conditions, the social and environmental externalities are particularly concerning, since they underlie many of the prominent social problems (especially the social discontent, distrust, and polarization that accompany the rising tide of populism) and environmental problems (particularly global warming) that are plaguing countries around the world.

[3] For example, https://www.economist.com/special-report/2016/06/23/automation-and-anxiety.

[4] See, for example, https://www.theguardian.com/technology/2020/nov/27/robots-replacing-jobs-automation-unemployment-us and https://time.com/5876604/machines-jobs-coronavirus/.

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What do these violations imply about the appropriate role of business in the market economy? To answer this question, let us consider the societal contribution of a business (i.e. its contribution to public welfare) in terms of its components.[5]

- **Customer surplus** is the customers' willingness to pay minus the revenue from the sale of the firm's products (which measures the value which customers derive from the product in excess of what they pay for the product; it is the sum of the areas beneath the demand curves for the firm's products and above the associated product prices).
- **Supplier surplus, including employee surplus,** is the cost of the firm's inputs minus the suppliers' (including employees') willingness to accept delivery of the inputs (measures the amount the suppliers receive for their inputs in excess of what the delivery of these inputs cost them; it is the sum of the areas under the suppliers' input supply curves and beneath the associated input prices).
- **Distributed profits.**
- **Corporate tax.**
- **Stakeholder externalities** are uncompensated net costs (costs minus benefits) to the stakeholders of the firm (e.g. workers, suppliers, customers).
- **Third-party externalities** are uncompensated net costs (costs minus benefits) impacting agents who are not stakeholders (e.g. unborn generations).

The sum of these components represents the total contribution of a business to society. What is remarkable is that, under the Invisible Hand conditions, profit is the only component of its societal contribution that the firm can influence. To see this, consider each of the components in turn. Under perfect competition, the firm is a price-taker and thus it cannot influence its customer surplus (since the product price and the customer demand curve are given to the firm) or its supplier surplus (since the input price and the input supply curves are given to the firm). Its corporate tax rate also lies beyond its control. The firm is assumed not to generate any externalities. Assuming symmetric information (so that neither side of the market has an informational advantage) and clearing markets, the buyers and sellers in each market face the same prices and thus the sum of the customer surplus and the supplier surplus cover the entire surplus available through the activities of the firm, its customers, and its suppliers. Assuming diminishing returns to scale and scope, the firm cannot become more productive by producing more than the perfectly competitive amounts of its products. Under these rarefied conditions, maximizing profit is equivalent to maximizing social welfare.

In short, under the five Invisible Hand conditions, the business of business should be the pursuit of profit. But when the Invisible Hand conditions are violated under the influence of the GTF nexus, the appropriate responsibilities of business need to be fundamentally reconsidered.

IV. Focus on the requisite drivers of change from the business perspective

The need for rebalancing the interests of business with those of society has become increasingly obvious. In fact, there is an enormous opportunity to ensure that market

[5] See Fleurbaey (2020).

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economies are actively harnessed to specifically address the kinds of challenge we now face. If we are to address the systemic issues of environmental risk and of social and economic inclusion, then we must ensure that our economic and business models are designed for this purpose. Doing so is difficult, however, since the decoupling process is the outcome of a systemic failure. Thus business cannot be expected to respond appropriately on its own. To understand the nature of the difficulty, it is useful to summarize how the primacy of the financial is currently reflected in the decision-making process of a business.

(i) Strategy

By definition, business plans, priorities, and decisions derive from a business strategy. And the primary (if not exclusive) focus of this strategy is to sustain and deliver financial performance. Underpinning this strategy is the responsibility to shareholders, which is deeply embedded in the legal and regulatory framework within which business operates.

(ii) Planning, implementation, and incentives

Each level of management in each business unit has objectives reflecting those in the strategic plan. These vary depending on whether the unit has direct revenue and profit responsibility. In all cases, the primary objective is to deliver financial outcomes over the period of the plan. The objectives cascade into the plans of management teams and staff, and form the basis of assessment—including incentive and performance rewards, promotions and career progress, etc.

(iii) Reporting

Management reporting is the data used to manage the business and incentivize performance. It is generally (if not exclusively) related to financial performance for revenues, costs and profits, as well as other key performance indicators (KPIs) (e.g. sales pipeline).

Similarly, external financial reporting (typically quarterly) is based on a combination of regulatory standards and requirements and the expectations of investors.

Analysts and investors use these reports to gauge the financial performance and outlook for the business, focusing on those two factors and any other KPIs that might influence performance.

External reporting is also intrinsically linked to governance. To make comparable investment decisions, investors need access to information based on a common reporting standard. Current standards are exclusively focused on financial performance, and are supported by a wealth of technical detail, expertise, an entire profession, and stringent regulatory requirements.

(iv) Governance

Governance frames the relationship between business owners (shareholders) and business operators. This includes a set of formal fiduciary/legal responsibilities that typically

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reflect the primacy of shareholders, as well as mechanisms like the management board and non-executive directors who are responsible (among other things) for representing the interests of shareholders in the oversight of the business.

A shareholding interest in a public company is usually an exclusively financial interest, managed by professional/institutional investors acting on behalf of others. The governance framework is designed to establish and reinforce this financial primacy. Access to public capital typically depends on the financial performance of a business, and this is intentionally embedded in its management and operating (and incentives) framework.

(v) The political and social context of business

Under the assumption that business leaders remain focused on shareholder value, policy-makers choose to influence business activity through monetary incentives (such as taxes and subsidies) and regulations. These policy interventions are designed to correct for publicly prominent environmental and social dysfunctions that may be expected to arise from the single-minded pursuit of short-term profit.

Furthermore, government procurement policy is often governed by the same principles of profitability as those used by business. For example, government infrastructure projects tend to be undertaken if the expected net present value of financial returns exceeds some threshold value. Social and environmental repercussions of these projects often do not figure adequately in this present value calculation.

In short, government policy is frequently designed to constrain profitability for the sake of social and environmental gains that can be expected to attract electoral approval. Thus it is not surprising that business leaders are often justified in their complaints that government policy is inefficient. Nor is it surprising that policy-makers are usually correct in their suspicion that business, left to its own devices, does not reliably act in the best public interest. In addition, it is not surprising that consumers and employees often feel that their genuine needs are subordinated to shareholder interests. These mutual frustrations of business leaders, policy-makers, consumers, and employees are built into the system.

As most goods and many services are the product of global supply chains that cross national and cultural boundaries, it is inherently difficult to mobilize cooperation within these supply chains with regard to more than profits. After all, the environmental and social net benefits are not measured consistently across companies and countries, if they are measured at all. Furthermore, profits may be reallocated flexibly across a value chain to ensure that all decision-makers within the chain have an incentive to do their share in generating the final products. Social and environmental net benefits, by contrast, cannot be reallocated flexibly, especially in the absence of common purpose. The pursuit of shareholder value *per se* is not sufficient to generate such common purpose.

Since business leaders, policy-makers, and commentators remain focused largely on profitability as the measure of business performance, and since GDP growth is often the focus of national economic performance, public norms and values are shaped accordingly. Within this framework of thought, social and environmental needs become less salient in the decision-making of consumers, employees, and voters. In short, norms and values evolve in a direction that reinforces the business and policy focus on economic—rather than social and environmental—returns.

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The conventional framework of economic analysis—which has had a dominant influence on the thinking of business leaders and policy-makers over the post-war period—is largely blind to the potential dysfunctionalities of the standoff, since economic analysis largely ignores social interactions and pays only limited attention to environmental costs that cannot be monetized.

V. Towards recoupled capitalism

This background offers an opportunity to identify the kinds of change necessary to support an evolution of the business operating environment in the service of recoupling. We focus particular attention on the systemic change required in response to the social and environmental externalities generated by the GTF nexus.

(i) From stakeholder value to societal value

The formal responsibilities of a business must specifically reflect the interests not only of the shareholders, but also of the stakeholders of the business. However, it is also necessary to ensure that that third-party interests—the interests of people who are significantly affected by business decisions but are not stakeholders of the business—are appropriately supported in order to achieve the overarching goal of recoupling. After all, the social and environmental externalities of business decisions—such as climate change and regional disparities in income, solidarity, and agency—fall not only on the firm's stakeholders, but also on third parties. There are third parties that are significantly affected—such as the unborn generations affected by climate change and the communities weakened by offshoring and automation—and these cannot be overlooked. This means that the purpose of business (in societal terms) must be extended not merely beyond shareholder value to stakeholder value, but also beyond stakeholder value to 'societal value' (including the significant third-party effects). As we shall see, this has significant implications for how businesses and policy-makers must work together in order to address the needs of communities that are not direct stakeholders of any particular business.

Needless to say, individual businesses cannot be expected to successfully pursue this evolution alone, however well intentioned. There are compelling examples of businesses taking a lead in this respect—this is necessary, but not sufficient to move overall economic activity at the required pace and scale. It is also difficult for a business to pursue stakeholder value—or broader societal value—when its competitors pursue shareholder value. There is no Invisible Hand of free market enterprise to ensure that the pursuit of societal value drives out the pursuit of shareholder value, particularly if the firm's stakeholders and governments do not promote societal value. On the contrary, insofar as profitability is a good predictor of business survival,[6] shareholder value is likely to win, since firms that single-mindedly maximize profits are likely to be more profitable than those who maximize profits subject to social and environmental constraints.

[6] Of course, business survival also depends on other things—such as barriers to entry and factor mobility—but these things do not systematically promote societal value.

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On this account, governments have an important role to play in shaping an appropriate operative business environment. This can be done in three broad ways.

The first is to set the responsibilities of business in accord with the public interest. These responsibilities must be reflected in the expression of both general duties owed as well as the specific corporate purpose of a business. The general duties to society have to be enshrined in the foundational legal responsibilities of a company, as determined by the government. On this basis, the company can specify its specific corporate purpose, which is founded in this overarching responsibility but is a specific expression of the reason why the particular business exists from the perspective of its direct stakeholders (see Mayer, 2018). This purpose must be clearly defined, its attainment must be measurable and reportable, and a company's directors must have a legal responsibility to deliver on this purpose. Only then can this purpose be expected to motivate the rules, practices, and processes of business governance systems.

The second way of shaping the operative business environment is through targets and requirements on all businesses, enabling these businesses to translate stakeholder and third-party effects into measures of business success. An important potential example is to be found in the net zero targets for carbon emissions, such as those passed in New Zealand's landmark climate legislation aimed at zero carbon emissions by 2050. Once these targets are appropriately defined for businesses—to achieve a scale of value-chain emission reductions necessary to limit global warming to 1.5°C above pre-industrial levels, while neutralizing residual emissions that are infeasible through permanent removal of equivalent amounts of atmospheric carbon dioxide—and then embedded in the operating requirements for business generally, then business is able to take environmental costs into account and to compete on a level playing field as it does so. With such targets in place, business can be given the latitude to exploit all profitable opportunities consistent with its purpose-driven objectives.

The third way in which government can shape the operative business environment is by influencing specific business activities through government policies driven by social and environmental objectives. For example, if a business wishes to participate in a large government procurement contract, it can be required to meet certain conditions in relation to environment (e.g. net zero), diversity (e.g. in terms of race and/or gender), and inclusion (e.g. minimum pay or 'living wage' levels through the supply chain). Governments can frame the expected outcomes beyond the financial and link these to social and environmental objectives. Within these new operational boundaries, businesses can then compete to make a profit, again on a level playing field. The same logic can apply to the formulation of any other policy measures, such as regulatory licences to operate, regulatory approvals, conditions for grants, or tax incentives.

While there has been some progress in addressing the environmental externalities through these three channels, much more remains to be done with regard to the social externalities. For example, individual businesses cannot be expected to take the third-party effects of regional disparities into account without appropriate collaboration with government.

With such collaboration, however, some of the most significant social challenges can be proactively addressed. For example, many countries wrestle with the 'levelling-up' challenge faced by distressed communities in particular geographic regions. This can be done by ensuring that measures of success beyond (but including) the financial are clear upfront, government and business work together to create the conditions necessary for business to operate (in terms of infrastructure, skills, and so on), and then

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business gets on with the business of business—competing to make a profit as a consequence of delivering on a corporate purpose which reflects the interests of its stakeholders, and underpinned by a broader responsibility to society generally. In effect, the market economy operates within a redefined set of boundaries that intentionally align the interests of shareholders, stakeholders, and society more broadly.

(ii) Measurement

A crucial step in this direction involves measuring the social effects of business—on both business stakeholders and third parties—including the above-mentioned effects arising from the GTF nexus.[7] Next, these measures will have to be translated into targets relevant for corporate reporting. Existing environmental, social, and governance (ESG) metrics lack the consistency and comprehensiveness that is required. The requisite changes in measurement and reporting of business performance calls for corresponding changes in accounting conventions.

Changes in the operative business environment along these lines must be accompanied by corresponding changes not only in measurement of business performance, but also in the measurement of policy effectiveness. Moving beyond shareholder value towards societal value of business must be accompanied by a movement beyond GDP towards social value of government. The role of government is to set the objectives and the boundaries of the business operating environment, not to unilaterally determine the means whereby the objectives are to be reached. The latter is the business of business.

(iii) Reporting and governance

On this basis, the reported performance of a business must reflect not only the financial performance, but also the performance in respect of societal and environmental impacts. Similar to current financial reporting standards, such external reporting must also be aligned with common standards for non-financial reporting, ensuring both consistency and comparability for investors and others.

A business must reflect these broader responsibilities and related objectives in its overall strategy and plans, which in turn must be reflected in the management of the business and the related incentives in place.

Moreover, the governance framework more broadly, from investors, to governance boards, to management teams, must be aligned so that the business activities are true to the broader social and environmental responsibilities of the business, including shareholders. Put differently, there cannot be an inherent conflict within the governance construct, which inhibits the capacity of the business to deliver on this basis.

To drive these changes, the emphasis in government policy, reporting of policy effectiveness, and public governance must also shift away from the primacy of the financial (economic efficiency, GDP growth) and towards broader societal outcomes, balancing the financial and the non-financial, and ensuring that business does likewise as it

[7] A first normative framework for measuring broad-based economic, social, and environmental components of societal wellbeing is described in Lima de Miranda and Snower (2020).

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participates in the market economy based on expectations and boundaries established by government designed to deliver recoupling.

Needless to say, civil society also has a major role to play in evolving the operating environment of business. For example, customers can favour purpose-driven firms through their purchases and employees' effort and loyalty can depend on corporate purpose. The changes in salient social norms and values not only affect the conditions under which business can pursue profit; they also affect the public sentiment motivating policy reforms.

VI. Concluding remarks

In sum, the purpose of business is to serve society. The maximization of shareholder value reliably promotes this purpose only under impossibly demanding conditions. Since these conditions are not being met in today's world, and since we see the evidence of the resultant decoupling continuing to grow, the framework within which business operates must be adapted to reflect a balance between shareholders, stakeholders, and society at large. The pursuit of profit is a valid and necessary objective in a market economy—but it must be earned as a consequence of delivering outcomes which are consistent with the wellbeing of the community and the sustainability of the planet. Policy-makers must embed these objectives and the related boundaries in the operating system for business, and the equivalent models which reflect governmental roles in the economy from procurement and investment, to licences and approvals, and ultimately to reporting. Businesses must reflect these objectives in their strategies, operating models, incentives, and governance frameworks.

We have an extraordinary opportunity—and responsibility—to reorient our market economies to intentionally serve the interests of the societies within which they operate, to reflect the interests of broader stakeholders as well as shareholders, and to do so sustainably. This requires us to be very intentional about reflecting this objective in the elements of our economic and business models which currently reflect the primacy of the financial. This applies to businesses, to governments, and to civil society. We must urgently recouple shareholders, stakeholders, and society.

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