

Repurposing our economies – and our businesses

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INTRODUCTION

This article is an invitation. It is an invitation to debate, challenge, supplement and evolve the content. But most of all, it is an invitation to recognize the need for fundamental systemic change to the manner in which our economies interact with our societies and to consider some of the primary elements of such change and how they might be developed and adapted to allow our "system" to function more effectively.

The case for change, and the basis on which this has come about, has been considered in some detail elsewhere¹ – and will not be repeated. This piece will focus on a deeper understanding of the changes to the basic premise and assumptions underpinning the way in which our economies and businesses have been designed to operate for many decades (and indeed beyond), and therefore a deeper understanding of what needs to change, and how, if we are to bring about greater alignment between business, economies and the societies within which they operate.

How can we reconcile two apparently conflicting scenarios?

1. It is fair to say that we have seen massive unprecedented global progress by almost any measure over the last 70 years. A billion people have been lifted out of pov-

erty,² world per capita income has quadrupled,³ global average life expectancy has increased from 48 years in 1955⁴ to 72 in 2016⁵ and now more than 300,000 people are gaining access to electricity and clean drinking water daily.⁶

2. It is also fair to say that we are seeing large-scale dislocation, mistrust and dissatisfaction in growing portions of the population in many – perhaps especially developed – countries. Over recent years, we have seen unexpected election and referendum results, the polarisation of communities and regular street protests as people make their discontent known.

In fact, not only are these scenarios reconcilable, they are the entirely logical outcome of some very basic principles on which economies and business have been constructed and managed for decades.

Adam Smith described how, in spite of their “natural selfishness and rapacity,” they “are led by an invisible hand to make nearly the same distribution of the necessities of life which would have been made had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing it, advance the interests of society.”⁷ A selfish business is actually a primary vehicle for social progress. Note, however, that the underlying premise was explicitly “to advance the interests of society.” One of Smith’s many extraordinary insights was to equate the selfish interests of individuals and their businesses with the best interests of the communities within which they operated.

Smith was also a product of his time, and his thinking showed this in two significant and related respects. First, “the interests of society” was by definition a

reflection of the social, moral and political context of the time. Second, and equally significantly, the same context informed and influenced the otherwise “selfish” behaviors of individuals in their communities. These otherwise selfish behaviors most certainly reflected an underlying sensitivity to the prevailing moral code.

»This changed context needs to be understood in a number of respects to consider how best to respond.«

Smith was acutely aware of this – his work, *The Theory of Moral Sentiments*, opened with the following statement: “How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.” Perhaps in today’s world, he might have used the word care.

In some respects, modern economic and business philosophy (and practice) owes even more to the Friedman doctrine, in which Milton Friedman claimed that,

“there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits.”⁸ We should remember that Friedman – like Smith – was writing in the context of his time. He was deeply concerned about the political risks to liberal democracy of requiring a business to engage beyond the profit motive and saw totalitarianism as a very real threat. His work took place many years before the prevailing communist regimes collapsed in failure. We should also remember that as businesses and economies adopted his credo with enthusiasm, the economic progress that followed did indeed deliver the unprecedented societal progress (in overall terms) we have seen since then.

However, the context within which Smith, Friedman and many other notable economic thinkers developed their theses has changed utterly. Their respective doctrines now operate in a hyperconnected interdependent world of global supply chains, fragmented business functions and relentless financial efficiency that none of them could have possibly imagined. The issue is not that they were wrong – in fact, one might credibly argue they have been proven to be correct as a consequence of the scale of human progress that has been made. The issue is that the world they believed they were designing for has itself changed utterly. They and many others made the compelling case for the role of the profit-motivated business as the primary vehicle for societal (or political) progress, and they were largely correct. However, this is typically because at the time, their work was also supported by an underlying context in which related behavioral norms were firmly established and

reflected the broader interests of other stakeholders, and the interests of society beyond the financial. Put simply, the profit motive worked so well and for so long because it was always supported by other factors that established norms of behavior to guide economic activity in broad alignment with the interests of society. We need to ensure that the profit motive continues to be buttressed and balanced to this effect for the future.

This changed context needs to be understood in a number of respects to consider how best to respond. First, as business began to operate on a truly global scale and as it became ever-more feasible to disaggregate functions and relocate activities, businesses inevitably became ever-less grounded and connected with their local communities – in other words, the moderating effect of the local, social and moral context became less relevant. Local relationships – with customers, employees and suppliers – became less significant. The same dynamic also changed the nature of businesses themselves – it became feasible for a business to become truly impactful on a global basis at a global scale. The combined effect of the globalization and the technology that emerged in the late ’80s, working in a system that was originally (intentionally) designed to have an emphasis on financial performance, began to create a disconnect between business and economic activity on the one hand, and societies on the other.

So how can we redesign our economies and therefore our businesses to advance the interests of society in a world facing both new challenges and opportunities?

The first and primary principle is to once again articulate the premise or objec-

tive for economic activity – to advance the interests of society. In simple terms, the challenge is to take Smith’s original framing and consider how it needs to evolve to reflect the world we live in now. The implications of this ambition are not simple, but they are profound. So much business and economic thinking has, for decades, been founded on the notion of profit-motivated businesses that to deconstruct, redesign and reorient the edifice that has emerged as a consequence is no small task – but it is a necessary and increasingly urgent one.

A business is successful and ultimately sustainable because – and only because – it meets a need, a need that is ultimately human in nature. A human or social need creates an opportunity for a business to respond, whether directly or indirectly. A modern economy is the most extraordinary mechanism for matching human needs and opportunities. But if a business – or an economy as a whole – fails to deliver on this purpose, and fails to meet the needs of its broader stakeholders on a sustainable basis, then the very existence of the business – or the economic system – is at risk. This applies to an individual business operating in a manner that customers, employees and/or others consider to be unacceptable – we have seen many examples of these debates emerge in recent years. It applies equally to an economic system as a whole that fails to address the needs of a significant portion of the society in which it operates, or which even threatens the sustainability of the planet. We see concerns at this level reflected in the political upheaval in many countries.

This does not mean that the objective is to dispense with market economies. Quite the opposite. We have learned from expe-

rience that market economies functioning broadly in alignment with the societies within which they operate deliver more effectively for citizens and communities than any other model we have seen. The market economy, the engine for matching human needs and opportunities, can be a great contributor to societal progress. The profit motive of each individual business is a necessary and essential component of any market economy. One question is whether it is the sole or primary component. More particularly, the real question is what is the means by which a business makes its profits? Market economies have always operated with certain facilitations and protections, as well as with certain boundaries and limitations, which naturally reflect a society’s expectations. By definition, therefore, these requirements, conditions and enablers also help establish norms, responsibilities and expectations. In a truly globalized, technology-enabled world, these norms and expectations need to be drawn more explicitly so that financial performance is guided toward – and in turn fuels – sustainable societal progress. The issue now is to determine how these factors must be redefined and redrawn for the world of today and tomorrow to facilitate thriving businesses and economies that in turn enable thriving and sustainable societies. We must recouple economic and societal progress.

Part of the complexity of the recoupling task at hand is, of course, that it requires a systemic transformation. It is impossible to address one aspect of change without making fundamental adjustments to a web of interlinked factors. The macro environment for business must be recast if business is going to operate differently

in the long term. Likewise, all aspects of the constitution and operation of the firm – from legal and fiduciary requirements, to cultural values and established norms, to measurement and reporting – are intimately connected and must be altered holistically and in tandem to affect meaningful and sustainable change. There is also a dynamic and undeniable relationship between the macro and micro that cannot be overstated. Efforts must be focused on overcoming localized challenges and realising localized opportunities while at the same time acknowledging the realities of a globalized world and all that it entails. The areas of focus I explore next should be understood as component parts of a much bigger picture, each acting as a lever that will inevitably influence the other.

»A modern economy is the most extraordinary mechanism for matching human needs and opportunities.«

1. PURPOSE OF AN ECONOMY

Adam Smith’s own phrase of “advancing the interests of society” seems a good

place to start in defining the primary objective of economic activity. However, it also highlights the immediate challenge – absent the ability to rely exclusively on the profit motive of a business (guided, of course, by the moderating influence of the social, moral and political context of the day) to deliver against such an objective, how are such interests to be determined?

While considerable progress is being made to identify means and measures to help define social progress, it is important to remember the two interdependent elements noted earlier: the profit motive and the prevailing societal perspective. Because the latter is effectively a matter of social, moral and political context, and the behavioral norms and expectations which emerge as a consequence, this implies that there will be significant variations in what are considered to be acceptable “societal interests” based on variations by country, or even by community within countries. This in turn implies that seeking to impose some form of standardized or default set of assumptions top down is very unlikely to be effective. Communities and countries will need to engage civil societies in meaningful debates about expectations, standards and objectives, and at a minimum, there will need to be some meaningful mechanism to facilitate/resolve debates about competing or conflicting interests. This latter point quickly highlights the systemic nature of this overall framing – regardless of the country-specific objectives, governance is required to facilitate progress where these interests potentially conflict, both within and between countries.

None of this is to diminish the significance or urgency attached to the need to

define and report broader measures of societal progress – these are critically needed to help orient economic activity toward alignment with the relevant societal objectives. In fact, much compelling work has been undertaken to define societal interests and alternative measures of success that move beyond the financial.

»Communities and countries will need to engage civil societies in meaningful debates about expectations, standards and objectives.«

These are not straightforward questions, and they have surfaced repeatedly over many years, initially highlighting the shortcomings of our current methods. In a 1968 speech to the University of Kansas, for example, US presidential candidate Robert F. Kennedy recognized that gross national product “measures everything... except that which makes life worthwhile.”⁹ In the period since, Joseph Stiglitz, among other leading economic thinkers, has ar-

gued that Gross Domestic Product (GDP) tells us nothing about sustainability.¹⁰ As it is argued in relation to the Social Progress Index (SPI),¹¹ “if people lack the most basic human necessities, the building blocks to improve their quality of life, a healthy environment and the opportunity to reach their full potential, a society is failing regardless of what the economic numbers say.” GDP has been increasingly seen as only a crude success measure, leading several pioneering organizations to explore alternative models. The Organization for Economic Co-operation and Development’s (OECD) Better Life Index, for example, allows for a better understanding of what drives the well-being of people and nations, and what needs to be done to achieve greater progress for all.¹² Similarly, the SPI offers a comprehensive measure of real quality of life, intended to complement rather than replace economic measures, such as GDP.¹³ Both initiatives reflect a vision of a world in which people’s needs come first.

It is also worth reflecting on the United Nations’ Sustainable Development Goals (SDGs)¹⁴ – not least because they potentially represent a truly global and consistent approach to defining the societal goals and outcomes to which countries wish to aspire, and for which, by definition, all countries will be relying on economic activity in one form or another to deliver on. However, as suggested earlier, there are some considerable challenges to be addressed in practice, not least of which is the need for individual countries to reflect both different realities but also different cultural and social preferences and priorities over the planning period. And without the engagement of civil society in this process, the legitimacy of the outcomes and

support for the ensuing actions will almost certainly be a challenge.

The SDGs are – perhaps inevitably – a hugely complex set of measures against which to progress on this basis. But if progress is to be made, then it is also essential to bring the role of the SDGs (and/or equivalent measures) to bear in economic and business purposes – and therefore policy and strategy – in a meaningful and achievable manner. This very likely leads to the following observations:

- Policy, as well as economic and business planning, likely needs to reflect the differing starting points and maturity of different countries for different factors.
- Similarly, countries will also likely have different cultural, political and historical perspectives on prioritizing the goals, as well as different norms and expectations.
- There is, therefore, both a prioritization required and a sequencing. Many of the goals are interdependent – and societies and communities will typically have a “hierarchy of needs” when considering how and when to progress, as well as in which order.

Once the debate moves beyond the notion of traditional “financial” measures of successful outcomes, stakeholder engagement is needed to define a country’s priorities in its broadest terms and to define the purpose of economic activity to advance these interests. With the announcement of its first Wellbeing Budget to take place in April 2019, New Zealand is making strides in this regard.¹⁵ The budget will formalize the country’s approach to delivering better living standards in line with the government’s belief that economic growth is a means to an end and not an end in it-

self. The New Zealand experience, alongside other initiatives already underway, is sure to prove instructive.

2. CORPORATE (OR “BUSINESS”) PURPOSE

Since the basic premise of (successfully) using economic activity to advance the interests of society has been founded on the assumption that this is effectively delivered by the “selfish profit motive” (as guided by the “invisible hand”), it is unsurprising that this same ethos has been heavily embedded in the rules, regulations and cultural norms and practices surrounding business behaviours and responsibilities.

Corporate purpose is typically focused on the equivalent of the Friedman doctrine – i.e., financial, short term and limited to shareholders – as stakeholders in which “there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”¹⁶

It is not at all surprising that an institutional framework (legal, investment, regulatory, management, governance, etc.) that has been designed to focus the activities of corporations on primarily financial and typically short-term results has been very successful. In fact, as we have seen, for a very long time, this was highly aligned with delivering societal progress. However, in an era in which we have seen greater misalignment in this regard, and a decoupling of economic and social progress with the attendant political reactions, it is essential that this same institutional framework is itself redesigned so that it explicitly de-

defines the expectations of business in a broader manner, redefines the purpose of a business in this regard and tackles the related changes needed in terms of governance, regulation and management.

This point again highlights the systemic nature of the change needed and the interdependence between the various elements. It will not be possible to refocus economic activity without redefining and then redesigning the related framework that establishes and drives the behavioral norms and expectations for individual businesses. And, by definition, therefore, this framework must flow into the related reporting obligations at both macro and micro levels, as well as the related need for alignment between the macro and the micro, of which I discuss more next.

It is perhaps worth the reminder that it is only in the last half century of the corporation's near two-millennia existence that profit has replaced public purpose as the sole corporate purpose.¹⁷ Initiatives are now emerging to redefine the purpose of a corporate entity and its responsibilities formally. The United Kingdom's new Corporate Governance Code is among those initiatives that go furthest by stating: "the board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture."¹⁸

The British Academy has launched important research in this area through the Future of the Corporation Initiative,¹⁹ setting out a reinterpretation of the nature of the corporation that focuses on corporate purpose, its alignment with social purpose, the trustworthiness of companies and the

role of corporate culture in promoting purpose and trust. It is a valuable contribution for policymakers and business leaders alike, and is sure to become even more instructive in its next phase as it examines a number of these areas in greater depth.

»A business which is not clear about its purpose within that framework may be putting its sustainability at risk.«

In the United States, Senator Elizabeth Warren has put forward the Accountable Capitalism Act,²⁰ targeting large companies with a new approach to corporate governance. The French government has also been rethinking the place of companies in society through its Action Plan for Corporate Growth and Transformation,²¹ which is intended to protect the notion of the social interest of a corporation, imposing a requirement that a corporation should no longer be managed solely in the interests of its shareholders but, more broadly, in line with the interests of society as a whole. These initiatives all represent attempts to

change the aspects of the framework in which business operates and provide a vital source of learning as we consider a broader systemic transformation.

There is an important distinction to be made between the "operating system" for business generally on the one hand and the choices which a specific business may make to make a profit within that system. The overall system should frame the choices available so that there is overall alignment. However, each individual business must determine its own purpose – within that operating system – and then compete vigorously and fairly to make a profit by delivering on the purpose which it has chosen to focus on. Put another way, making a profit is an entirely appropriate consequence of successfully executing on the purpose that a business has chosen within the overall framework. In fact, a business which is not clear about its purpose within that framework may be putting its sustainability at risk – making a profit could be seen as an increasingly unacceptable motive when it appears to derive from activities which are otherwise considered by society as unacceptable and unsustainable. We see more and more examples of this kind of tension arising for individual businesses in today's world – and very often at moments of crisis.

3. MEASURING AND REPORTING FACTORS

Building on the perspectives described earlier, it is clear and understandable that the reporting responsibilities of businesses have been focused primarily (and arguably exclusively) on the financial performance of the business, primarily based on the responsibilities to its shareholders and

primarily focused on the relatively short term (and arguably the very short term). In a similar vein, macro-economic reporting has tended to focus on a narrow range of metrics, with a particular emphasis on GDP.

Two observations are immediately relevant.

The first is that at both the macro and the micro level, current approaches to measurement and reporting are neither sufficient nor effective, especially in the context of the shift needed away from an exclusive emphasis on short-term financial results.

There has been a proliferation of initiatives, standards and frameworks to help companies deliver on an ambition to measure and report on more than just financial outcomes, and beyond Corporate Social Responsibility initiatives. This momentum partly reflects a shift in investor preferences but also both consumer and employee demands. The launch of the Compact for Responsive and Responsible Leadership²² at Davos in 2017, for example, marked a comprehensive global corporate effort to define a framework for business leadership according to long-term sustainability principles. This framework lends greater coherence to private-sector efforts, many of which have strived to incorporate Environmental, Social and Governance (ESG) information into their operations over many years. The Leadership Compact is an addition to the multiple initiatives that have already been established internationally to encourage business to operate responsibly and sustainably, and to report on their activities.²³

However, there is still a long way to go. The absence of commonly held termi-

nologies, guidelines and market standards continues to be a hindrance, along with inadequate data, the dominance of short termism in the financial markets and inconsistent baselining, leading to a lack of comparability of data. As it stands, there is little common understanding and practice to evaluate how business is impacting sustainability and people's well-being.

The second observation may be less obvious, but it is highly significant. Since the selfish profit motive was identified as the guiding premise for delivering societal interests, it is unsurprising that both macro and micro reporting largely converged around an emphasis on largely equivalent metrics, which are largely financial in nature. In light of the misalignment which has now emerged, it will be equally key to ensure that there is a high degree of synergy between the reporting which takes place at both a macro level and corresponding micro level to foster the desired realignment. Otherwise, we should expect that business will continue to focus on one set of outcomes as defined, frankly, regardless of how these outcomes align with the interests of the society within which the business operates.

This is not to suggest that any single business should be treated as a microcosm of an entire economy and report on this basis – but it does suggest that there are societal interests on which businesses have profound influence – and these factors will need to be more prominently reported on in a consistent manner. This is also a reflection of an equally significant reality: that societal outcomes are a reflection of activity in both the public and in the private sectors. Governments, as well as businesses (and hybrids thereof), will

need to be clearer than ever about their respective goals, expectations and responsibilities in the context of who is expected to play which role in delivering on target objectives.

There are a number of ways in which macro and micro metrics can be better aligned. If Gross National Income (GNI) is used as a macro indicator, for example, measuring the total income of all residents, it is possible to then consider a number of corresponding indicators at a micro level. A business contributes to GNI by generating income for residents – far more than just its profit. Its contribution consists of all the (value-added) income paid to shareholders, creditors and workers. Indicators at both the macro and micro levels must be consistent with a reasonable conception of the well-being of a population. This still allows for some flexibility when selecting indicators, of course, because there are diverse conceptions of well-being and different approaches to aggregating it as a whole.²⁴

When reviewing a select number of other macro indicators, it is possible to explore their micro equivalents. A dashboard approach, for example, establishes a range of indicators and allows the study of how micro entities contribute to each one. If income inequality is a macro indicator, one method to measure a business' contribution to it is through the distribution of wages in the payroll and to compare it to the distribution of wages in the economy. In the case of synthetic indicators (such as human development indexes), a similar approach can be taken in which each component of the macro-level indicator will align to its corresponding micro indicators. This exercise must, however, take into ac-

count the calibration required at a micro level to reflect the process of aggregation at a macro one. Other methods include "subjective well-being," which would require the use of empirical surveys to glean levels of stakeholder satisfaction with businesses and "equivalent income" (e.g., OECD Multidimensional Living Standards) which correct income for non-market aspects of quality of life and can be adapted to the level of a company by making corrections to the bottom line or to the total value added to the company.

4. RESPONSIBILITIES TO "STAKEHOLDERS," CORPORATE GOVERNANCE AND OTHER NORMS AND INCENTIVES

I have referred to the reality that in many legal systems, businesses are legally required to operate in a manner that is primarily, if not exclusively, responsible to shareholders. This is typically a reflection of the evolution of the notion that "the business of business is business",²⁵ as described earlier. However, it becomes an obvious hurdle if economies are to look to deliver on societal interests, especially if these are now viewed as much broader than (or even challenged by) the narrower focus on shareholder interests. A thorough review of corporate governance in this context is clearly required, building on the debate needed to address the nature of corporate purpose as described earlier, including shareholders' and other stakeholders' responsibilities. It also encapsulates other factors that are often attributed to the overall emphasis on "shareholder value" as the driving force for business strategy and corporate decision making. And this same frame of reference is embedded in business culture and

management approaches within organizations – management responsibilities and incentives which drive behavior equally reflect a typical emphasis on the financial and on the short term, and which in turn is reinforced by the resulting reporting framework not only externally but also within the typical business.

»Current approaches to measurement and reporting are neither sufficient nor effective.«

This is not to suggest that financial performance (and discipline) is not a necessary element of a market economy – it clearly is. The question is the degree to which it is the primary (exclusive) factor and the degree to which other target outcomes are supported (or actively inhibited) by equivalent drivers of behavior and norms. Financial success must be a (worthy and desirable) consequence of a business operating successfully in overall alignment with the interests of society. This means the various factors that establish norms of behavior in this regard – investor expectations and requirements, legal requirements, reporting obligations, governance, management incentives,

etc., – must all work together to support this alignment. The “wiring” of our economies must be examined and redesigned to focus on this.

»Our system as a whole needs to be rewired.«

At the level of the investment community and its operating framework, a growing number of financial institutions have been showing interest by launching new initiatives to support the SDGs. For example, the United Nations Environment Programme (UNEP) Finance Initiative and Principles for Responsible Investment (PRI),²⁶ representing more than 1,800 organizations with combined approximately \$80 trillion in assets under management,²⁷ are working with the UN Global Compact to create innovative financial products that have the potential to redirect public and private finance toward critical infrastructure and solutions that are integral to the SDGs. The World Bank has launched a program of equity index-linked bonds, which will allow investors to contribute to the financing of sustainable development projects and benefit from the performance of companies making a significant contribution to the SDGs.²⁸

A large number of principles have been in effect for some time, among them the Equator Principles, UN Principles for Sustainable Insurance, UN Guiding Principles in Business and Human Rights, Climate-Wise Principles and Green Bond and Green

Loan Principles, as well as standards, including World Bank/International Finance Corporation (IFC) Performance Standards (plus other regional bank equivalents) and Climate Bonds Standards. Banks also tend to follow a wider range of principles and standards for specific issues: for example, the Wolfsburg Principles, UN Global Compact, Montreal Protocol, etc., as well as others, for disclosure. The upshot is that there is no shortage of frameworks in place for companies to orientate themselves to broader stakeholder considerations. Furthermore, the number of ESG or sustainability-related indexes around the world rose from less than ten in 1993 to hundreds today and continues to increase as more retail and institutional investors seek to integrate ESG criteria into their investments.²⁹

We have also seen new models emerge, contrasting with the traditional corporate construct. For example, more than 2,500 companies across 150 industries are now certified B Corporations.³⁰ B Corporations consider the impact of their decisions on their workers, customers, suppliers, community and the environment, and represent a dedicated and growing movement to align business priorities to those of the communities and broader societies in which they operate. Certified B Corporations also amend their legal governing documents to require their board of directors to “balance profit and purpose.”

The obvious and significant challenge is that, notwithstanding the availability of so many initiatives and frameworks, the default premise for most businesses reflects the behaviors and norms established by a system designed to focus on financial performance above all else.

This is reflected in investor expectations and requirements, legal and fiduciary responsibilities, management practices and strategies, reporting and standards, business education and training, rewards and incentives and so on. Having described all of these disparate elements as the “wiring” of our economic and, therefore, business systems, all of these and the other elements of our system need to be oriented in alignment with the broader societal needs and outcomes. Our system as a whole needs to be rewired.

5. THE FLAWED PHILOSOPHY OF “EXTERNALITIES” IN TODAY’S REALITY

Once it was accepted that the “selfish” profit motive was a basic premise for economic and, therefore, societal development, it was perhaps inevitable that there was a need to invent the concept of “externalities” – a way of managing factors external to that premise and therefore to the models designed to reflect it.

Since the underlying premise is no longer functioning sufficiently well, so too do we need a new way to think about the factors which are or were external to such a model. This is not only relevant to economic theory and practice; it is highly relevant to business strategy and performance. Building on the original premise, businesses typically measure, report and manage on the basis of financial performance which also ignores “external” costs – for example, whether related to health costs or environmental costs or any other similar factors where the costs are indirect and must, therefore, be borne by “someone else.” During Smith’s lifetime, of course, natural resources were in plentiful supply, and the planet could support the popula-

tion’s needs. In today’s world, this is a good illustration of how the system which has developed will actively inhibit the ability of an economy to deliver on broader societal interests – the reported financial performance of a business must by definition be an overstatement if it does not reflect the indirect costs of doing business which arise directly as a consequence of that business. It also represents a significant challenge to the appropriate allocation of capital, since investors cannot fully assess the risk of particular business activities. By addressing externalities (by ensuring that to the greatest extent possible they are internalized), both investors and companies can make better business decisions, based on fuller, more accurate information and bring an integrated approach not only to the management of risks but also to performance improvements and longer-term value creation. It is also a means to build trust with different stakeholder groups in the process. These are all integral to a collective effort to drive common purpose.

The obvious conclusion in light of the changed premise is to redesign models of economic and business performance and reporting to minimize externalities. And in doing so, we should not assume that all human activities must fit into an economic model – many critical aspects of human well-being are by definition outside the scope of the market and outside the scope of economic activity. Put another way, we now need to stop explaining why the world doesn’t fit with our original economic and business models, and change the models to ensure that they reflect our world.

Efforts are underway to consider how this might be done. One example is the International Integrated Reporting

Council's (IIRC) principles for integrated thinking and reporting, which are being implemented by approximately 2,000 organizations around the world.³¹ Principles such as value creation, the longer term, future orientation and "multiple capitals" are embedded in the Integrated Reporting Framework.³² Where properly adopted, this enables more strategic and integrated information sets that show the relationships between human, social and natural capital, for example, and their impact on financial performance – bringing a new perspective to decision makers both internally and externally. Another example is the European Union Non-financial Reporting (NFR) Directive, which now requires 6,000+ companies to ramp up reporting of environmental and social aspects of their operations. The directive represents a minimum standard for non-financial reporting across the EU and allows for considerable flexibility for member states to develop an approach that works in the respective contexts.³³

There also is very interesting work being done to bring such externalities within the reporting responsibilities of business – for example, in relation to climate risks in UK banks, requiring banks to recognize financial risks on their balance sheets attributable to climate change.³⁴ On a global level, the Financial Stability Board – a G20 advisory body – established the Task Force on Climate-Related Financial Disclosures (TCFD)³⁵ to provide greater transparency to company reporting, ultimately giving investors the information about climate and environmental risks they need to make better informed decisions on where to deploy their capital. TCFD figures (August 2018) show that

over 290 companies have expressed their support for the recommendations, with a combined market capitalisation of over \$6.6 trillion.

Recent research³⁶ by PwC, in collaboration with the Natural Capital Finance Alliance (NCFA), UNEP and Global Canopy, warns that most financial service providers are still not assessing the financial risks associated with environmental degradation. While banks have made progress on disclosing environmental risks, most are failing to assess the sustainability of their entire portfolios and how they will be affected by, for example, droughts, floods and heat waves. By placing financial value on natural resources, a natural-capital approach would integrate the management of ecosystems with economic decision-making and development. While financial institutions are increasingly making a dedicated effort to measure their impact on sustainable development by integrating ESG information into their work, there is a long road to travel. Despite the many worthwhile examples of a growing commitment to sustainability activity and reporting, firms that are measuring their impact only represent a small percentage of the estimated US\$135 trillion aggregate balance sheet of the banking sector globally and the approximately US\$100 trillion investment assets under management.³⁷ This "gap" is a good illustration (again) of how all of the component parts of the system are interdependent and need to point in the same direction – if the governance and reporting frameworks are not supportive and consistent, the issue of externalities will continue to be a fundamental challenge. There is clearly more work to do.

6. COMMUNITIES MATTER MORE THAN AVERAGES

One of the significant challenges in the many debates now underway about our political and economic systems is a tendency toward the polarization of perspectives – especially about participation in the global economic system. The globalized economy has been painted by many populist politicians as a factor in – if not the primary driver of – the negative outcomes experienced by frustrated segments of the population. In other words, the globalized economy is a bad thing.

»Progress on average is not a sufficient measure of success.«

In a similar vein, defenders of the globalised economy point to the enormous progress which has – as a matter of fact – been made in overall terms over the last several decades, a period of unprecedented societal progress by almost any measure, which could not have happened without a globalized economy.³⁹

The difficulty is that both perspectives are valid. Populist politicians can appeal to increasingly large segments of the population because these citizens are increasingly dissatisfied – whether or not this is actually attributable to participation in the global economy. The bottom line for these

concerned citizens is that their economies are not seen to be serving them well, for whatever reasons. And it is true to say that global economic activity has delivered massive social progress in overall terms – but large segments of the population in many economies feel left behind. Average global progress is meaningless (or worse) if it appears (or you believe it) to be coming at your expense.

There are some key themes that emerge. First, there are compelling arguments in support of the value which an interdependent globalized economy delivers, but that does not mean that economies generally do not need to evolve to address the needs and interests of those who do not feel they are participating – for whatever reason. Progress on average is not a sufficient measure of success. Second, and following from this, it is critically necessary to focus on the needs of communities in geographically more specific terms, rather than to risk "masking" these needs by focusing on policy measures intended, for example, to drive overall or average economic growth, typically in financial terms. There are some interesting examples of where a different approach has been taken.

In severely disinvested US neighborhoods, for example, the notion of "community wealth building" was developed to start systems change, with its roots at the local level. When Cleveland had lost a significant percentage of its population and many of its public companies because of deindustrialization, the Evergreen Cooperative was established to create a more sustainable local economy and generate living-wage jobs in low-income neighborhoods.

Similarly, in the northern town of Preston, United Kingdom, the local city council took an “ultra-localist” approach to economic policy in the wake of the last recession. By encouraging “anchor institutions” – so-called because they were unlikely to up and leave – to buy the goods and services they needed from local businesses wherever possible, the council shaped the market to suit the community. Research carried out by PwC UK and the British think tank Demos revealed that Preston is the most rapidly improving urban area in the United Kingdom to live and work.⁴⁰

The Cleveland and Preston examples, and others like them – including the US Investing in Opportunity Act⁴¹ and Mondragon cooperative⁴² in the Basque country – have started to form part of the answer to our strained economic system by applying new design principles at a local level, working to create economic inclusion from the outset, as well as designing policy for the holistic success of communities in broad human terms, rather than primarily narrow economic or financial ones.

Another good example is Project Nagarik⁴³ in India. This initiative supports employment generation where it is needed most, in the smaller districts of India, where a majority of Indians reside. It develops employment strategies that leverage the state’s core capabilities and existing strengths, creates linkages to market needs, identifies what’s required for long-term and sustainable employment generation and forges a concrete role for citizens alongside government and the private sector in the process. In doing so, this collaborative, locally grown model for employment generation is shifting the economic balance within the country and creating

new opportunities where they have been steadily dwindling.

The Saigon South Urban Development Project in Ho Chi Minh City, Vietnam, also adopted a dedicated focus on job creation, education and infrastructure investments, and has built up a new sustainable, inclusive, knowledge-based urban center.⁴⁴ There, an area of swamp land with no road access, water or electricity has been transformed to create a liveable, sustainable city. Residential neighborhoods, hospitals, shopping malls and office buildings have developed, each meeting a new social need within the urban community. Today, 65,000 people from over 40 countries live in the city centre and over 10,000 service-sector jobs have been generated, with a boost to workers’ skills.

»The objective here is to create not just commonality of interest, but commonality of purpose.«

These strategies are all diverse and unique to the local circumstances that have caused them to emerge, but all of them have a common commitment to improving the lives of people living in their respective communities. They have been proactively

designed with a far broader, more holistic view in mind of the human and social needs of a community that go far beyond the financial. The economy is not treated as the answer but a means to a human end. This is in contrast to the default assumptions that have underpinned the traditional approach to business and economic thinking for decades, where often the opposite is true.

7. FIX THE SYSTEM, NOT JUST THE SYMPTOMS

The examples above represent attempts to redesign the current system so that it is inclusive from the outset and working in the interests of people and their communities.

This is a very different premise compared to a focus on redistribution to address the implications of disrupted communities, regions or demographics – people left behind when jobs fade or depart (or were never available in the first place). We must recognize that the systemic change is needed not only for those who currently participate in the economy, it is even more urgent for those who are or may become excluded from such participation – and this clearly links to the related comments on geography and skills.

This debate is important today in the context of discussion about the globalized economy and the challenge of responding to those who have become marginalized. However, it is also critically important in the context of the disruption that is inevitably still to come as new technologies impact at scale – as they surely will. It will likely not be acceptable to respond by redistributing (in financial terms) to provide minimum levels of support to those excluded – whether in the form of Universal Basic Income or otherwise. This will not

satisfy people’s individual or social desires for fulfillment, intellectual stimulation, teamwork, productivity and personal growth. The concerns of families and communities likely relate to anxieties about empowerment, control, fairness, trust and estrangement. Responding with an emphasis on financial redistribution may lead to a future without hope or true care. This is not a sustainable or desirable future.

Our economic engine – our operating system – now needs to be oriented to recognize and then deliver on what makes communities and societies successful, and supporting people to thrive from the outset, rather than excluding them and then trying to manage the consequences. We can learn a huge amount from the local and other examples noted earlier that are attempting to do precisely this.

8. GOVERNMENT POLICY AND MARKET RESPONSE

One of the most challenging and perhaps contentious debates is, and will likely continue to be, around the role and relationship between government on the one hand and business on the other – finding the right and successful balance between “intervention” by government and the effective functioning of the market economy. However, this question becomes even more significant in the context of a reframing of key assumptions that have underpinned economic and business strategy in the manner described earlier.

A key point to make at the outset is that the effective functioning of a market economy has always required some degree of regulation or intervention, not least to preserve the essential characteristics of a functioning market, including competi-

tion – which by definition, for example, requires antitrust provisions. Market economies have always been guided by a policy framework that reflects the political and societal context. The reframing described requires a fresh perspective on how these guidance measures should be defined and implemented to reflect our intentional focus on the purpose of an economy to support societal interests.

»The Fourth Industrial Revolution offers huge potential to transform and realign economies and societies.«

This suggests that the overarching objective should be for policymakers to ensure that the guidance measures are designed so that the economy is aligned to the greatest extent possible toward delivering on societal interests, but that otherwise the level of intervention should avoid inhibiting the effective functioning of the market economy. The objective here is to create not just commonality of interest, but commonality of purpose.

To reiterate a key point made earlier – this does not mean that the selfish profit motive is problematic – quite the opposite. It is both necessary and desirable for a market economy to function. The policy framework – the operating system – provides the opportunity for a business to make profit successfully in a manner that is aligned with the interests of (or at minimum not contrary to) the society within which it operates – this is how commonality of purpose comes to life.

There are some interesting examples of this principle in action. The UK government established the Business Innovation Facility,⁴⁵ a market systems development program that aims to improve the lives of the poor by identifying and addressing constraints in selected emerging and developing countries, providing technical assistance to business and other market players, and replicating business models that make markets more inclusive.

In Germany, government policy ensures the same level of infrastructure (broadband, roads, etc.) across different regions to drive private-sector and small- and medium-sized enterprise (SME) activities outside of primarily large, urban centers, and to create more opportunities in all regions of the country. This has enabled specialized enterprises to prosper in remote areas as well as urban centres and has also led to most German citizens living in small- and medium-sized towns, rather than large cities, with a correspondingly high standard of living.⁴⁶

These two examples also highlight the growing reality of differing political systems around the world that are using common approaches to leverage market economies but based on very different political

models. China is an obvious example, of course, but by no means the only one. The Belt and Road Initiative (BRI) has been called a Chinese Marshall Plan, echoing the effort made at the end of the Second World War to regenerate Europe. Covering over 70 countries, 65% of the global population and 30% of global GDP,⁴⁷ the BRI is a state-led programme (enshrined in the constitution) that is simultaneously stimulating economic activity, providing a strategic vision for the alignment of public authorities and business to deliver and potentially creating the world's largest platform for regional collaboration. The implications of such a large-scale investment continue to be debated, but BRI nonetheless provides an interesting example of how a country or a region can establish a vision in which economic activity is intentionally used to deliver broader outcomes, rather than as an end in itself.

As political systems wrestle with the implications of a globalized, technology-enabled world, combined with the power of market economies, we are very likely to see further variants of these models emerge.

9. LEVERAGING – AND MANAGING – TECHNOLOGY

Technology is neither inherently good nor bad – but its deployment is having an unprecedented impact on human beings and society more broadly. The blistering speed with which technological developments have unfolded has left no time for citizens, governments, academics, business leaders – or even the tech architects themselves – to consider what we are gaining and losing as a result of new technologies coming into play. The cultivation of tech-

nology within the context of a new societal framework that puts people first, locally and globally, would create a new platform for discussions over the boundaries, principles and ethics associated with technological advancements. It would also underscore the huge opportunity that exists to use technology to facilitate businesses and therefore economies addressing social needs.

The Fourth Industrial Revolution (4IR)⁴⁸ offers huge potential to transform and realign economies and societies. 3D printing can be used by suppliers of school cafeterias and hospitals to make the mass production of meals more wholesome or by construction companies to produce affordable, disaster-resilient homes in just 24 hours. Firms that supply medical equipment or machinery parts can do so at low cost and to a high degree of personal specification.⁴⁹ Some Fintech companies are identifying products and services that meet the varied needs of their consumers and delivering them in a tailored way – for example, mobile wallets and digital lending platforms are enabling customers to pay their bills, carry out peer-to-peer lending and use their mobiles without even having a bank account. This is having a particularly profound impact for many of the “unbanked” communities in developing countries while at the same time potentially providing early warning signals of systemic financial strains. In transport, advanced materials, including graphene and nanosolutions, are close to underpinning battery breakthroughs for inexpensive, quick-charging, energy-dense batteries that could make new products – electric cars – viable and both performance and cost competitive.⁵⁰

Equally, technology presents significant risks and challenges, both in relation to the implications for employment and, more broadly, in terms of data acquisition and usage, as we have seen. It is critical, therefore, to ensure that technology is actively managed to align with societal needs. There is, of course, an ongoing debate in this area. Concerns over upheaval in labor markets, growing inequality and declining trust in dominant companies and their use of data are catalyzing discussions over the regulatory and other tools that should be introduced to shape the digital era.⁵¹ Current lags are creating tensions between traditional and digital firms, and between digital firms and policymakers,⁵² and may also result in public frustration.

From a broader economic perspective, the scale of disruption that new technologies will certainly catalyze for many traditional jobs will be hugely significant. PwC UK's analysis suggests that a significant percentage of jobs could potentially be at high risk of automation by the early 2030s – specifically, 38% of US jobs, 35% in Germany, 30% in the United Kingdom and 21% in Japan.⁵³ In fact, 60% of people PwC surveyed think few people will have stable, long-term employment in the future.⁵⁴ This factor alone will require significant policy, economic and business planning and response. It is true to suggest that many new jobs will be created, and indeed, many more existing jobs will likely be augmented by technology, rather than replaced. We see both factors in play already. But these new and augmented jobs will typically require very different skill sets on the part of those already in employment, or hoping to join the workforce. Governments and businesses will need urgently to work closely

together to plan for these skills, for the disruption; to encourage and facilitate the innovation needed to allow new businesses to be created at enormous scale to replace major job losses; and so on and so on. Many of the elements of systemic change described in this article will be needed to orient our economies to respond to these changes – including the element which immediately follows: the need to protect people, not jobs.

10. PROTECT PEOPLE, NOT JOBS

We are living through a fundamental transformation in the way we work. Automation and “thinking machines” are replacing human tasks and jobs, and changing the skills that organizations are looking for in their people. These momentous changes raise huge challenges at a time when business leaders are already wrestling with unprecedented risk,⁵⁵ disruption and political and societal upheaval.

Many analysts focus on technology itself and the role that automation is predicted to have on the workplace. But the picture is far more complicated. The real issue is less about technological innovation and more about the manner in which humans decide to use that technology. The shape our future will take will be the result of a range of competing forces, all of which are unfolding at a speed that is hard to predict.

As more and more individual tasks become automated through artificial intelligence and algorithms, jobs are becoming redefined and recategorized. Some sectors and roles, even entire sections of the workforce, will lose out, and others will be created. PwC research in this area revealed that 37% of people surveyed⁵⁷ are

worried about automation putting their jobs at risk, reflecting a growing sense of anxiety that may continue to take hold around the world.

It is highly likely that automation will not only alter the types of jobs available but also their number and perceived value. The replacement of workers doing routine tasks will increase the comparative advantage of those workers with problem-solving, leadership and creative skills. These skills will be prioritized by employers, and yet CEOs believe finding the right skills they need has become one of the biggest threats to their business – 79% of CEOs in PwC's 2019 CEO survey⁵⁶ say they are worried about finding the skills they need, and 62% are saying they find it more difficult to hire workers in their industry. There is no doubt that we need adaptability – at both an organizational and individual level – to navigate the inevitable scale of change that we have ahead.

This implies that we need to be deliberate in the way we allow technology to develop, recognizing and managing, at all stages, how it affects society. Mass unemployment is a deep concern, and 56% of people surveyed think governments should take any action needed to protect jobs from automation. However, it is arguably important in this context to go one step further. The labor market will change radically, and organizations cannot protect jobs that are made redundant by technology. But they do have a responsibility to their people. It will be critical to nurture agility, adaptability and reskilling in the workplace of the future.

The education system also must evolve to equip people with the skills they need to succeed, placing greater emphasis on in-

demand skills and encouraging people into patterns of lifelong learning. When asked, the majority of people (74%) said they are ready to learn new skills or completely retrain to remain employable in future.⁵⁸ As individuals express their willingness to do what they can to remain relevant for the future, there is no doubt that education and training as a whole will need to be rethought to equip them with the skills to work in a global, interconnected labor market and, increasingly, a technology-enabled environment.

»It will be critical to nurture agility, adaptability and reskilling in the workplace of the future.«

11. RELEVANT GOVERNANCE FOR RELEVANT GEOGRAPHIES

I have highlighted the risks of polarizing the debate between global versus local – in fact, a focus on both is needed and valuable. The same logic applies to governance arrangements.

There are a range of hugely significant issues which require countries of the world to participate in global or regional multilateral institutions. The degree of interdependence in our global economy

is both significant and complex, and cannot function without a common framework supported by common rules and resolution mechanisms, as well as the supporting institutions. The same logic applies to a range of issues that cross national boundaries, from terrorism to migration to health. And a highly compelling example is, of course, the sustainability of our planet in response to climate change.

In all these cases, however, we must be willing and able to articulate the value of these multilateral approaches in terms that resonate with individual communities and in individual countries. This cannot be a philosophical debate about the merits of an approach – it must reflect the needs of the societies and communities it is intended to serve. The nature of the governance must reflect the nature of the challenge to be addressed – which also means that for the many issues which can and should be addressed at a more local or regional level, so too should the governance for such issues be more local or regional. The purpose of multilateral institutions must be clear in terms of their purpose, and this must align with the needs of the societies which they support. For example, the imperative of global free trade must explicitly intend to address societal interests and must be intentionally designed to do so and actively facilitate identifying and addressing any downside risks or issues, and then communicate accordingly.

This proactive and explicit emphasis on the principle of subsidiarity may seem obvious. Unfortunately, however, the urgent and compelling need for multilateral institutions and approaches to deal with the complex global challenges we now face is under real threat in many places. It is more

important than ever to be able to articulate the importance of international cooperation in terms which reflect the real concerns of individuals and local communities, and to ensure that such cooperation is executed and communicated accordingly.

»Rewiring our system based on this principle may appear complex, but it is possible.«

CLOSING REMARKS

The key message of this article is simple. Our market economies have been the most successful means of delivering social progress for many decades and beyond. This premise is now challenged with growing misalignment between economic activity on the one hand and outcomes that are both sustainable and acceptable for societies on the other.

The most basic principle that pervades each element of the thinking described is to refocus our economic and business activities on outcomes that are human rather than primarily financial. For the reasons I have described, this is not the design principle embedded in our current system – it needs to change.

Rewiring our system based on this principle may appear complex, but it is possible. Our economic engine to match

human needs and opportunities has the potential to adapt and evolve to ensure that the profit motive is oriented in alignment with societal progress and sustainability.

The various elements of such an evolution and the related examples described earlier are certainly neither wholly complete nor wholly correct. The changes

envisioned will require imagination and collaboration on the part of many different stakeholders, a willingness to debate and challenge, to listen and learn and to experiment and iterate. The task is both urgent and important. I hope this article makes some contribution to stimulate and support the progress needed.

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