

A man in a dark suit and glasses stands with his back to the camera, looking towards a modern building with large glass windows. The scene is in black and white. A large, textured red graphic element, resembling a torn piece of paper or a brushstroke, is overlaid horizontally across the middle of the image. Two vertical columns of coins are visible on the red graphic, one on the left and one on the right, with some coins appearing to be falling or stacked. The background shows the interior of a building with columns and lights.

**SHAREHOLDER
CAPITALISM**
A SYSTEM IN CRISIS

SUMMARY

Shareholder capitalism – a system driven by the interests of shareholder-backed and market-fixated companies – is broken.

Our current, highly financialised, form of shareholder capitalism is not just failing to provide new capital for investment, it is actively undermining the ability of listed companies to reinvest their own profits. The stock market has become a vehicle for extracting value from companies, not for injecting it.

No wonder that Andy Haldane, Chief Economist of the Bank of England, recently suggested that shareholder capitalism is ‘eating itself.’¹

Corporate governance has become dominated by the need to maximise short-term shareholder returns. At the same time, financial markets have grown more complex, highly intermediated, and similarly short-termist, with shares increasingly seen as paper assets to be traded rather than long-term investments in sound businesses.

This kind of trading is a zero-sum game with no new wealth, let alone social value, created. For one person to win, another must lose – and increasingly, the only real winners appear to be the army of financial intermediaries who control and perpetuate the merry-go-round.

There is nothing natural or inevitable about the shareholder-owned corporation as it currently exists. Like all economic institutions, it is a product of political and economic choices which can and should be remade if they no longer serve our economy, society, or environment.

Here’s the impact this shareholder model is currently having:

- **Economy:** Shareholder capitalism is holding back productive investment. Even the Chief Executive of BlackRock, the world’s largest asset manager, has admitted that pressure to keep the share price high means

corporate leaders are ‘underinvesting in innovation, skilled workforces or essential capital expenditures.’²

- **Society:** Shareholder capitalism is driving inequality. There is growing evidence that attempts to align executive pay with shareholder value are largely responsible for the ballooning of salaries at the top. The prioritisation of shareholder interests has also contributed to a dramatic decline in UK wages relative to profits, helping to explain the failure of ordinary people’s living standards to rise in line with economic growth.
- **Environment:** Shareholder capitalism helps to drive environmental destruction. It does this by driving risky short-term behaviour, such as fossil fuel extraction, which ignores long-term environmental risks.

The idea that shareholder capitalism is the most efficient way to mobilise large amounts of capital is no longer tenable.

We need both to create new models of companies, and implement new ways of organising investment that are fit for building an inclusive, equal, and sustainable economy.

Companies should be explicitly accountable to a mission and a set of interests beyond shareholder returns. Equally, investment must provide long-term capital for socially and environmentally useful projects, and damaging forms of speculation must be restricted.

For most people, our economy simply is not working, and the damaging aspects of shareholder capitalism are at least in part responsible. Reforming shareholder capitalism must not be dismissed as too difficult – the crisis is too urgent for that. We can take the first steps towards a better economic model right now. It’s time to act.

RECOMMENDATIONS:

Change the ownership, control, and purpose of corporations, including stronger reporting on public purpose and increased responsibilities for shareholders.

Abolish Limited Liability for wholly owned subsidiaries, ensuring full protection is only for those exerting no influence on the company.

Reform investment to curtail predatory high-frequency trading, to clarify pension funds’ legal responsibilities, to add measures to limit conflicts of interest within the equity market, and to create a new state investment bank.

Companies should be explicitly accountable to a mission and a set of interests beyond shareholder returns. Equally, investment must provide long-term capital for socially and environmentally useful projects, and damaging forms of speculation must be restricted.

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1. INTRODUCTION

Modern shareholder capitalism has been subject to critique by commentators from a range of different backgrounds in recent years, including the boss of Mckinsey and the Chief Economist of the Bank of England.^{3,4} In this report, we review the history of the shareholder corporation, from its origins in the provision of public investment to its modern 'financialised' incarnation, complete with high-frequency trading (HFT) and 'dark pools.' We argue that the model of shareholder primacy is no longer fit for purpose and question whether it was ever a superior model for organising the economy. New corporate forms and alternative channels for capital allocation are required to meet the economic, social, and environmental challenges of the twenty-first century.

By shareholder capitalism, we mean an economic system in which the dominant corporate form is legally independent companies that can pool capital from many shareholders with limited liability, complemented by an open stock market to trade these shares freely. The model has led to a system today where the ultimate measure of a company's success is the extent to which it maximises shareholder value. This should then naturally optimise the returns to wider society and the economy in the same way that each of us pursuing our own self-interests should maximise the returns for all. There have always been those who claimed that a model of capitalism based on large, profit-driven companies would lead to the development of centres of unaccountable power that produce destructive social and environmental impacts.⁵⁻⁷ But more recently, a new and more damaging charge is being levelled at this system: that a mutant form of 'financialised capitalism' has seen the tail of shareholder value increasingly wagging the dog of corporate investment. This line of argument questions the fundamental efficacy of the corporate structure and the equity market as they presently exist to facilitate investment, asking whether they are undermining its foundations. Concern is being raised from all sides, both within the investment industry itself and without, that the main beneficiaries of financialised capitalism are financial intermediaries rather than investors or wider society.

Andy Haldane, Chief Economist of the Bank of England, commented recently that 'the main reason why world growth has been subpar is because businesses have not been investing sufficiently.'⁸ He added that businesses 'are almost eating themselves', concluding that while the

public corporation and the associated equity market have certainly delivered on a number of measures, especially historically, 'you can have too much of a good thing.'⁹

Haldane's view aligns with the findings of a major review of UK investment undertaken by John Kay in 2012 – the Kay Review – which concluded that 'short-termism is a problem in UK equity markets and that, the principal causes are the decline of trust and the misalignment of incentives throughout the equity investment chain.'¹⁰ It added that 'short-termism in business may be characterised both as a tendency to under-investment, whether in physical assets or in intangibles such as product development, employee skills and reputation with customers, and as hyperactive behaviour by executives whose corporate strategy focuses on restructuring, financial re-engineering or mergers and acquisitions at the expense of developing the fundamental operational capabilities of the business.'¹¹ An explosion of intermediation, Kay argued, has created a system which serves neither companies nor savers, but works primarily for the benefit of financial intermediaries.

And yet, perhaps most extraordinarily, even these middle-men are beginning to openly suggest that the system is dysfunctional. This sentiment is neatly encompassed in a recent statement by the CEO of Blackrock, the world's largest asset manager with \$4.6 trillion in assets under management:¹²

*'...more and more corporate leaders have responded with actions that can deliver immediate returns to shareholders, such as buybacks or dividend increases, while underinvesting in innovation, skilled workforces or essential capital expenditures necessary to sustain long-term growth.'*¹³

In other words, shareholder capitalism is not even working for the long-term interests of shareholders. When one of the most powerful players in, and leading beneficiaries of, the current system can openly say that it is undermining what was its original purpose – to facilitate long-term investment in companies – it is clear that something has gone very wrong indeed. The charge of short-termism is backed up by the numbers: people are holding shares for significantly less time than 50 years ago, with the average holding time of stocks consistently reducing over time across exchanges globally, even when accounting for the rise of computer-based trading.

Interestingly, the Kay Review also concluded that 'UK equity markets are no longer a significant source of funding for new investment by UK companies ... the principal role of equity markets in the allocation of capital relates to the oversight of capital allocation within companies rather than the allocation of capital between companies.'¹⁴ Again, this statement has profound implications. Shareholder capitalism has always been justified as the only way to mobilise private capital on a large scale and channel it into productive enterprise. If it is no longer fulfilling this function, it is surely time to question whether the system as we know it has outlived its usefulness.

Particularly since the crisis of 2008, many economists and academics are beginning to ask precisely this question, with some 'proclaiming the death of mainstream finance theory and all that goes with it, especially the efficient market hypothesis, rational expectations, and mathematical modelling.'¹⁵ Turning to the corporation, some, such as eminent criminologists Steve Tombs and David Whyte, have gone so far

as to suggest that ‘the corporation cannot be effectively reformed, not through corporate social responsibility, not through regulation, not through tinkering with structures and functions. It is an essentially destructive, irresponsible phenomenon. In short, the goal of corporate opposition must be the abolition of the corporation.’¹⁶

All of this matters because of the immense power that shareholder-owned corporations wield – not just over our economy, but over our politics as well. Ira Jackson, the former director of Harvard’s Center for Business and Government, recently noted that corporations and their leaders have today ‘displaced politics and politicians as ... the new high priests and oligarchs of our system.’¹⁷ The wider economy seems to serve their interests even when it runs against the long-term interests of people and the environment. Governments seek their advice when creating policy and legislation. Their lobbyists and representatives ensure that their voices are heard, even when not requested.

How did all of this come to pass? Before we consider the future of shareholder capitalism, we must first understand a little of its past. Did the corporation rise to dominance out of economic necessity? How have equity markets, created to raise capital for and trade stock in these companies, evolved over time? And do these structures still make sense in the twenty-first century? In the remainder of this report, we examine each of these questions in turn.

Section 2 looks at the history of the corporation, charting its journey from a vehicle to deliver public goods to its modern incarnation of a limited

liability, profit-seeking entity, as well as explore the development of early equity markets together with some their challenges.

Section 3 documents the financialisation of the corporation and equity markets since the 1970s. With regard to the corporation, the section looks at the rise of the shareholder primacy doctrine, its critique, and the attempt to rectify it under the Company Act 2006. It then charts the impact on equity markets of Big Bang deregulation, the rise of algorithmic trading using computers, and how it came to dominate trading. Finally, we look at how fundamental economic theories, such as the efficient markets hypothesis (EMH) and modern portfolio theory (MPT), have proven to be deficient in the modern age.

Section 4 examines the impact of this form of financialised capitalism by investigating its impact on the economic, social, and environmental spheres.

Section 5 seeks to reimagine the corporation and equity markets for the twenty-first century. The first part looks at how to reform corporate governance and explores other forms of ownership so that it is better able to meet the needs of a wider group of stakeholders. We then examine potential changes to the legal structure of limited liability and how its application should be limited to incentivise good corporate behaviour. Finally, we look at how to reform equity markets and mitigate the potential negative impact of computer-based trading, and at new models of investment which could make equity markets work better, such as evergreen direct investment or a British investment bank.

2. A BRIEF HISTORY OF CORPORATIONS AND EQUITY MARKETS

Many of the corporate characteristics that we take for granted are quite recent innovations. There is nothing natural or inevitable about the shareholder-owned corporation as it currently exists. Like all economic institutions, it is a product of political and economic choices made at particular points in history for particular reasons, as well as responses to external factors and chance.

Corporations have a long history dating back to the thirteenth century, but the structure, purpose, and ecosystem surrounding them have changed radically over the last eight centuries, with change accelerating from the early nineteenth century. Corporations were originally company structures enacted by royal charter to carry out a specific activity in the public interest, like building a bridge or university, without generating any significant profit. Over time, the core function of corporations became to make profit for their owners or shareholders.

Two major developments that were essential to the rise of the corporate structure were **separate legal personhood**, which made the corporation its own person before the law, thus separating it from its owners, and **limited liability**, which ensured that shareholders were only liable for the amount they invested. Although considered commonplace today, these were radical departures from established and accepted practice, which was that people should be fully liable for the business activities that they engage in and that a business cannot be separated from the individuals who comprise it.

The other innovation that helped to secure the modern corporation as the dominant business form was the ability of people to **buy and sell stock** in companies, with the creation of joint-stock companies in the seventeenth and early eighteenth centuries, along with stock markets. At their most fundamental, stocks, or shares as they are commonly known, are a right to a portion of the profits of the company.

The genius of the corporation as a model stems from its ability to combine the capital, and thus the economic power, of very large numbers of people, while restricting the liability of those investors. This has traditionally been viewed by economists as the key

feature that ensured, almost through economic necessity, the corporation's meteoric rise over the last 300 years.¹⁸

This section charts the rise of the corporation and challenges this accepted narrative, arguing that the origin of the 'modern corporate legal form is to be found not in the needs of industry but in the needs of finance.'¹⁹ In other words, the roots of our current form of shareholder capitalism – which increasingly appears to benefit only the financial elite – can be discerned even in the early emergence of the corporation.

2.1 FROM PURSUING PUBLIC GOALS TO PRIVATE PROFIT

There was a significant shift in the late sixteenth and early seventeenth century towards endowing for-profit companies with both Royal Charters and the benefits of a distinct corporate structure. Early English law had considered that whenever people acted together with the primary goal of generating profit rather than delivering a public good, the courts would deem a partnership to be in existence and hold the partners fully liable for any action of the company, even if it had been established by Royal Charter.

The initial beneficiaries were the new colonial corporations who were vested with significant powers to exploit the commercial opportunities of colonialism. They had the specific purposes of opening new trade routes and settling new lands. The earliest example was the Company of Merchant Adventurers in 1553.

The most famous example of this new breed of company is the East India Company, which was given its charter in 1600. This granted it exclusive rights to trade and to establish trade ports in India and South-East Asia for 15 years. The East India Company was primarily answerable to its shareholders, and

to some extent the Crown. This was unlike previous publicly focused chartered corporations who had a duty to fulfil their charter first and then generate profit. This became the standard model, at least for companies exploiting the colonies.

2.2 TURBULENCE OF THE EARLY STOCK MARKET

In the 1700s, partnerships and individual proprietorships were still the dominant form of company structure.²⁰ Although in other European countries these partnerships tended to be with very close family, since liability was unlimited, people in Britain showed a much greater willingness to partner with their wider circle of acquaintances. This may have been one of the factors that allowed the UK to become more productive; it was easier for entrepreneurs to raise capital and form businesses.

In 1711, the South Sea Company was formed to trade in South America, despite the overwhelming control exerted by the Spanish and Portuguese in the region. Although the company would extract some concessions to deliver slaves to the region, in time the deal crumbled due to war. To save the company, the directors devised a plan to allow the UK government to convert government debt into company equity. Its appetite for debt continued to grow and they were able to attract the great and the good, from MPs to the King's household, to invest. The powerful elite now had a strong vested interest in ensuring an ever-increasing stock price, meaning a rising return for themselves. As the company got into more and more debt and was unable to meet its obligations, interested parties started rumours causing fervent speculative buying of the stock and huge price increases. When the company was denied access to the region, the price of its stock collapsed and some of the directors were jailed.

This became the now infamous South Sea Bubble and caused the first stock market crash – an early example of how ‘animal spirits’²¹ and the self-interested abuse of inside information can combine to separate the price of company stock from its fundamental value. The conventional narrative holds that the bubble led to the 1720 Bubble Act – which forbade anyone not directly involved with the company in question from trading in its shares. The facts, however, contradict this. They demonstrate that the creation of the Bubble Act predated the crash and was in fact ‘an attempt to hinder alternative investment opportunities and to divert more capital to South Sea shares’²² by restricting investment in other companies.²³ The bubble represents an instance of a wider problem that we face today with ‘owners’ pursuing short-term self-interest at the expense of other stakeholders and the wider economy.

The Act did lead to some companies being wound up and for the next 100 years Charters reverted to being granted mainly for public works. The Act, however, was poorly drafted, leading to ambiguity over its application. This, coupled with weak enforcement and a widespread disregard by businessmen, meant it lacked impact. In the first 80 years of its implementation, the only case to be brought before the court, in 1722, concerned trade in the North Sea. In fact, during the 100 years of its enactment, joint stock companies increased in both power and number.²⁴

The Bubble Act was finally repealed in 1825 allowing a formal return to the buying and selling of stock in companies. This re-ignited interest in the structure of the joint stock company and started a key period during which some of the major pillars that define modern corporations were constructed, namely separate legal personhood and limited liability.

2.3. SEPARATE LEGAL PERSONHOOD FOR ALL

The 1844 Joint Stock Companies Act allowed corporations to be created without the need for a Royal Charter and thus vest a company with any purpose with a separate legal personality.

The orthodox view is that this vehicle was a more effective way to raise large amounts of capital, especially for large infrastructure projects demanded by the Industrial Revolution. This can be evidenced by the fact that as railways expanded, joint stock companies were able to raise £230 million – ‘a more than 1000-fold increase’²⁵ on what had previously been raised. This development gave anyone the ability to incorporate their business as a legal person separate from the shareholders, traditionally seen as the ‘owners’, and then issue stock from that company. It is clear from UK company law, however, that ‘shareholders are not, in the eyes of the law, part owners of the company.’²⁶

A review of the data shows that the Industrial Revolution was mainly carried out by partnerships and traditional forms of companies, not corporations, as the old narrative goes.²⁷ Esteemed economist and historian David Landes notes that ‘the simple fact is that Britain did not need Joint Stock Companies [Corporations] to finance her Industrial Revolution.’²⁸ There were of course exceptions like canals, railways, and public utilities which did require the mobilisation of huge amounts of capital from a diverse group of individuals that needed a legal identity separate to that of those providing the capital.

WHO OWNS A PUBLICLY LISTED COMPANY?

The common conception is that the shareholders, by virtue of the fact that they own a percentage of the shares in a company, own a corresponding percentage of the company. The narrative is intuitively appealing but lacks any legal basis in UK law.

In fact, no one legally *owns* a public company. The company is, as the law intended, a separate entity or person, which often has many different types of claims against it. Just as you cannot 'own' another physical person, but you can have duties towards an individual or rights against them, the same applies to a publicly listed company. Shareholders in fact do not own part of the company but have a series of rights that go together with owning the share.

When a person acquires 1% of the shares in a company, what they gain is a right to 1% of the dividends paid by the company if it chooses to do so (a decision which the person has no power to initiate) and 1% of the remaining capital if it is wound up. Owning shares can also sometimes give a person voting rights that can be exercised at AGMs or other special meetings. What issues can be voted on depends on the company but often include issues like remuneration packages, dividend payments, and other issues that impact their holding, like share split or merger/acquisition.

This is true even if someone were to own 100% of the shares, since they would still not be at liberty to use the assets as they saw fit. The company remains a wholly distinct entity that continues to own all the company's assets.

Owning shares therefore bestows valuable rights on the holder but those rights can in no way be equated with actual ownership of the company.

However, these kinds of enterprises could have been granted all the privileges that they needed by Royal Charter. It is not clear that these exceptional cases should have been the basis on which to structure all companies. In addition, in 1848, it was revealed that 'most railway companies – the poster child for the modern corporation – were in fact profitless and paying dividends to the shareholders out of capital.'²⁹

2.4 LIMITED LIABILITY

A major barrier to early entry into stock ownership was the fact that owners, however poor, remained fully personally liable for all the company's debts. This meant that investing in a company put your home, your savings, and all your assets at risk. The established wisdom of the time held that this provided a strong incentive for those who owned and managed companies to avoid insolvency and protected the interests of wider stakeholders, such as customers and creditors, from risky company behaviour.

The 1855 Limited Liability Act legally limited the liabilities of investors to the amount that they had invested in the company. Owners were therefore no longer responsible for the debts or actions of the company beyond their initial investment. Those in favour argued that it was not fair for people who invested a few pounds in the stock of a company to be liable without limit. Fundamentally, its goal was to entice a new class of investors into the market and allow the middle classes to benefit from the possibility of investing. Liberal MP William Clay articulated the sentiment well: 'unlimited liability has a tendency to deter persons of fortune, intelligence and respectability from becoming partners or managers of joint stock banks.'³⁰

Interestingly, a Select Committee hearing on partnership advocated for limited liability on the basis that it would be 'an additional motive given to preserve order and respect for the laws of property.'³¹ This could be interpreted as an early means of enticing more people into the emerging capitalist system by encouraging those earning disposable income in the Industrial Revolution to invest in joint stock companies. A mirror of this dynamic can be seen in the modern era with the increased financialisation of ordinary people's lives through pensions and larger mortgages which tie more and more people into stock market performance and the banking system, thereby influencing attitudes and behaviour towards these structures.³²

Those against the implementation of limited liability opposed it, mainly on moral grounds, on the premise that it would undermine personal legal responsibility. This had been seen as a bedrock of company practice for centuries. Victorian industrialists were strongly opposed to limited

liability.³³ In 1854, a Mercantile Law Commission reported that 'although the details of our mercantile law may require correction ... it would be unwise to interfere with principles which ... have proved beneficial to the general industry of the country.'³⁴ The introduction of limited liability, the argument went, severely softened the incentive to avoid insolvency as well and helped evade responsibility for losses and damage caused to wider society by the actions of the company.

These two acts of parliament led to *The Economist* pronouncing that 'everyone was in stocks now ... needy clerks, poor tradesmen's apprentices, discarded service men and bankrupts',³⁵ but also created a new incentive dilemma. If those people holding shares, often active managers, were no longer responsible for the losses incurred by the company and inflicted on society, what incentive would they have to operate in a safe and efficient manner? Indeed, with shareholders' downside risk protected, what incentive would there be for them to get actively engaged in overseeing company operations in the first place?

2.5 THE INEVITABILITY OF THE MODERN CORPORATE FORM

There is a commonly held view that the joint stock company represents the most efficient way of organising capital and labour with its ability to pool small amounts of capital from many people to enable large-scale investment. In order to maximise the potential and the effectiveness of this new type of entity, separate corporate personhood, limited liability, and the ability to trade shares were all inevitable and necessary. Framing this as an almost natural evolution 'in effect placed [these developments] beyond critical examination and evaluation.'³⁶

An alternative perspective is that the rise was due to the industrialisation of Britain and its expansion into an Empire.³⁷ The Industrial Revolution and colonial conquest generated huge wealth for a small number of individuals. Those individuals sought places for their money to be productive and earn them more without putting their fortune at risk. In the 1900s, partnerships still dominated the company landscape, and they generally funded their expansion through the re-investment of profits rather than receiving money from outside investors. Many partnerships therefore had little need for investors who merely wanted to earn a return on the money they had injected into the company. These investors therefore sought easier vehicles which exposed them to less risk than trying to muscle in on existing partnerships. The scholar Paddy Ireland suggests the real reason for the meteoric rise of the modern corporation was to protect investors and that this was driven in large part because it was a politically expedient construct, not an economic necessity.³⁸

These 'revisionist' interpretations suggest that the potential for productive enterprise to be hijacked by the interests of finance capital may always have been latent in the institutions of shareholder capitalism. The development of a new and more financialised form of capitalism in the twentieth and twenty-first centuries has seen the full potential of financial capital realised.

2.6 CONCLUSION: FROM PUBLIC BENEFIT COMPANY TO INVESTMENT VEHICLE

The long early years of the corporation as a specially chartered company to deliver a specific public good show us a way in which the power of the corporation can help deliver for society. At this time, there was a trade-off between society and the corporation. In return for the corporation providing a public good, like a university or hospital, society would offer this entity certain rights, namely personhood, limited liability and, later, the ability to trade in its shares. Unlike today, deviation from the original charter of the company or an attempt to make excessive profits would see these rights removed immediately.

The major structural and legal changes to corporations and the market of the eighteenth and nineteenth centuries ensured that these rights were bestowed on all registered companies irrespective of their aims, purpose, or behaviour. The reforms were not principally undertaken to protect and promote businesses, which were still largely formed of partnerships and had little appetite for, and even resisted the reforms, but to foster the interests of a financial capital. By the early twentieth century, the corporation had fully metamorphosed into a potent investment vehicle for financial capital, with society severely curtailed in its ability to focus their purpose or rescind their rights.

In the next section, we show how the interests of financial capital continue to be prioritised as we explore how the twin developments of shareholder value ideology and ever faster and more complex financial markets have resulted in the distinct and dysfunctional form of shareholder capitalism we have today.

3. FINANCIALISATION: A NEW PHASE OF SHAREHOLDER CAPITALISM?

In the twentieth and early twenty-first centuries, and particularly since the 1980s, two parallel sets of developments have changed the character of shareholder capitalism. At company level, corporate governance has become increasingly dominated by the ideology of maximising shareholder value. At the same time, financial markets have become more and more complex, highly intermediated, and short-termist, with shares increasingly seen as paper assets to be traded rather than as long-term investments in sound businesses.

In this section, we start with an exploration of the rise in shareholder primacy, as well as modern developments in company law. The second part looks at developments in the equity market and how the Big Bang, computers, and the rise of the intermediary came to radically reshape how and in whose interest the institution works. Finally, we assess how developments in economic theory, such as the EMH and MPT impacted these changes.

3.1 SHAREHOLDER VALUE ORIENTATION

The doctrine of shareholder primacy

Andy Haldane notes that in the nineteenth century, 'maximising shareholder return was not the centrepiece of companies' objectives or directors' duties.'³⁹ Early writers such as George Rae and Walter Leaf, chairman of Westminster Bank, spoke of an 'obligation of doing what he could for the common good'⁴⁰ and that there should be 'constant attention to public interest in the first place.'⁴¹ In the years following 1855, a number of laws were enacted to enshrine measures aimed at protecting shareholders, such as publishing company financial figures, AGMs, rights of shareholders to sue directors, and voting rights for shareholders.⁴²

In the late nineteenth and early twentieth centuries, the principle of shareholder primacy started to be formulated and developed. The theory outlines that in corporate governance, the shareholder's interests should be assigned primacy relative to all other corporate stakeholders when deciding what action a company should pursue. This led to the seminal 1932 book by Berle and Means – *The Modern Corporation and Private Property*⁴³ – which called for implementing shareholder primacy and bestowing on shareholders the necessary rights and powers to meet that objective.

This was based on the notion that managers are essentially ‘agents’ acting on behalf of their ‘principals’, the shareholders, and must be prevented from abusing this position for their own ends – both by aligning managerial incentives with the interests of shareholders, and by ensuring that shareholders can hold managers to account (both directly, through the exercise of ‘voice’, and indirectly, through ‘exiting’ or selling their shares). The main purpose of the corporate governance regime is to facilitate this accountability. As discussed in Section 2.3, this is based on the flawed assumption that shareholders ‘own’ companies. And it is particularly questionable in the context of today’s equity markets, which, as we shall see later in this section, are no longer a net provider of new capital to UK listed companies, as well as other markets.

From the 1970s onwards, a mutant form of shareholder primacy, under which the sole purpose of a company was to make money for its shareholders (rather than to provide useful goods and services which had the *effect* of making money for shareholders), began to take hold. In the 1970s, Milton Friedman, one of the most prominent intellectuals in what would become known as the neoliberal movement, wrote an article in the *New York Times* that advocated for an extreme version of the doctrine of shareholder primacy. Friedman stated:

‘...in a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society.’⁴⁴

Even though this formulation is a fundamental misunderstanding of company law – since executives are employees of the corporation and not of the shareholders – this became a dominant meme, feeding into the teachings of business schools and management guides. Under this doctrine, executives could only pursue activities that did not directly make money if they would ultimately increase shareholder value. Business guru Peter Drucker commented that ‘if you find an executive who wants to take on social responsibilities, fire him, fast.’⁴⁵

One of the key impacts of this movement was a radical shift in how senior executives were remunerated, with increasing prominence of payment in shares and equity-linked instruments such as stock options. Between 1980 and 1994, the value of stock options given to large company CEOs rose by 700% while their cash bonuses rose by less than 100%; by 2006, the average CEO salary was only 20% pay, less than 30% bonus, and more than 50% stock options.⁴⁶ It was argued that this would help resolve the ‘principal/agent’ problem by aligning managers’ interests directly with shareholders’ interest in maximising the share price. However, there is now growing evidence that performance-related pay has failed to improve company performance,⁴⁷ or even to protect the long-term interests of shareholders.⁴⁸ Instead, the main impact of these increasingly complex pay arrangements has been to ratchet up executive pay to previously unimaginable levels.^{49,50}

However, shareholder value thinking has been successful in one respect: encouraging managers to focus relentlessly on short-term share price movements. From the 1980s onwards, an increasing percentage of corporate executives saw their main duty as

maximising short-term shareholder value above all other considerations.⁵¹ By 2005, one US study found that 78% of financial executives said they would give up long-term economic value to maintain smooth earnings flows to their investors in the short term.⁵²

But by the 2000s, questions were beginning to be asked about the model. Jack Welch, CEO of General Electric, was widely celebrated on the stock market for his ability to hit share price targets – but in 2009 he famously described shareholder value as ‘the dumbest idea in the world.’⁵³ Even Michael Jensen, one of the leading academics who promoted the ‘alignment’ of executive pay with shareholder value, subsequently recanted – expressing concerns that it in fact incentivised executives to maximise short-term profit figures, regardless of underlying value, in order to maximise their own pay-outs.^{54–56} This reflects a growing acknowledgement that adherence to the mantra of shareholder value is both a questionable interpretation of company law and a dubious, even self-defeating, approach to running a successful company.^{57–59} Ultimately, shareholder value orientation is an ideological construct that can and should be challenged.

The Companies Act 2006: ‘enlightened’ shareholder value?

In the UK, the Companies Act 2006 – a major codification of company law – attempted to clarify the responsibilities of directors towards their shareholders. It was the culmination of over ten years of deliberations, consultations, representations, drafting, and debate and at the time was the largest statute ever passed by Parliament. One of principles that the legislation wanted to enshrine was to put enlightened shareholder value at the heart of UK business. This culminated in Section 172 of the Act that states:

1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- *the likely consequences of any decision in the long term,*
- *the interests of the company’s employees,*
- *the need to foster the company’s business relationships with suppliers, customers and others,*
- *the impact of the company’s operations on the community and the environment,*
- *the desirability of the company maintaining a reputation for high standards of business conduct, and*
- *the need to act fairly as between members of the company.*

This framing is often called ‘enlightened shareholder value’ because it allows directors of the company to consider the interests of wider stakeholders such as employees, suppliers, customers, and the environment, whilst making clear that this is not their primary duty. Although the Act does not explicitly state that directors’ primary duty is to their shareholders – but rather to promote ‘the success of the company’ to the benefit of shareholders – it has generally been interpreted as confirming the principle of shareholder primacy (i.e., the duty to act ‘for the benefit of its members’).

In the debates surrounding the passage of the Act, numerous voices called for a move to a more balanced stakeholder governance model, more similar to those found in continental European economies, such as Germany.⁶⁰ The compromise of enlightened

shareholder value was intended to clarify that companies are not obliged to maximise profit at any cost, whilst avoiding formal rights for other stakeholders in corporate governance. In this it appears to have been largely unsuccessful, with one study by the UK Department for Business Industry and Skills finding that although there was increased awareness, this had resulted in minimal behaviour change,⁶¹ with another study for the Association of Chartered Certified Accountants finding that it had made little impact on directors' behaviour or their interpretation of their legal duties.⁶²

So despite being under no legal duty to do so, and despite the best efforts of lawmakers and progressive business schools, the model that fetishises shareholders and their short-term interests remains one of the key driving forces of modern corporate behaviour.

3.2 EVOLUTION OF FINANCIAL MARKETS: FROM INVESTING TO INTERMEDIATING

Although equity markets had been around for many centuries, changes since the middle of the 1980s have radically changed the institutional structure, the exchanges themselves, the mechanisms through which trades are made, and the entities that perform the trades.

The Big Bang reforms of the late 1980s reshaped the institutional framework of the market with their focus on deregulation, technological innovation, and privatisation. These changes ultimately forced the exchanges to prioritise traders and their needs rather than provide a neutral trading environment. Innovations in computers and the advent of algorithmic trading also created a new means by which financial capital could extract value. In the new model, stocks were no longer

bought because of their fundamental or future prospects but on the basis of trying to predict short-term market movements or find arbitrage opportunities. Not only did the rise of these new intermediaries change the nature of the equity market, but the ownership of the shares also shifted away from individuals and towards highly diversified institutions. Continued belief in the EMH and MPT has only served to further foster the belief in the new models and reinforce the self-reflexive nature of the market.

The Big Bang: changes in regulation

The main stated rationale for the Big Bang deregulation of 1986 was a perceived need for modernisation and a desire to settle an anti-trust case initiated by the previous government regarding certain restrictive practices.⁶³ Supporters of the reforms argued that they were essential in order to bring the stock market into the twentieth century. The three major changes were (i) to allow all firms to become broker/dealers and able to operate in a dual capacity; (ii) to move trades from being conducted face-to-face on a market floor to being performed via computers and telephones from dealing rooms not located at the exchange; and finally (iii) the privatisation of the stock exchange itself.

The intent of the first reform was to dismantle the old siloes with very distinct roles for brokers, jobbers, and advisors. The new investment banks housed all these roles under one roof. While disrupting the old boys' network of old, this created new problems of its own, as one of its architects, Nigel Lawson, now concedes: 'Nobody at the time realised that if you put everything together, there would be a problem.'⁶⁴ The period of consolidation which followed the Big Bang resulted in a system dominated by a few huge

financial conglomerates undertaking a wide range of activities, creating major conflicts of interest (as, for instance, the same firm could act for both companies and investors on either side of a deal) and potential for rent extraction – as well as concentrating systemic risk by concentrating operations and reducing diversity.

The reforms also contributed to a shift from a *relationship-based* culture (where whom you knew was important and entry into the space was hard, but which allowed for long-term trusting relationships with clients) to a *transaction-based* investment banking culture (which was more meritocratic, but refocused incentives on seeking the largest possible reward in the shortest possible time) – or as one observer has put it, 'from looking after the long-term interests of your client to making the biggest buck out of today's deal.'⁶⁵

Meanwhile, privatisation of stock exchanges threatened to undermine their ability to perform their previous public utility function, which was to ensure a neutral and effective marketplace in which investors could sell stock as well as allow companies to raise capital. In their privatised guises, their single-minded goal became to grow the volume of shares traded on their exchange, even at the expense of the integrity of the markets and client relationships themselves. This was one of the factors that allowed for the rise of speculative trading in larger volumes divorced from the real economy, as the exchanges sought the trade volume generated by the growth in computer-based trading. This trend was exacerbated by the rise of multiple exchanges competing with each other to attract business. On the one hand, this injection of competition forced established players like the London and New York Stock Exchanges to

modernise; on the other, it drove exchanges to adapt their offerings and practices to ensure maximum market shares, rather than provide a neutral ground to trade shares fairly.⁶⁶⁻⁶⁹

Rise of the robots: automated trading and HFT

Since the 1990s, automated trading, along with its modern supercharged incarnation HFT, has thrown into question who, or what, is really trading stocks and whether trading requires any knowledge of the fundamentals of a business and whether prices reflect real-world values.

Although in many ways the shift to electronic trading was inevitable, given the wider shift in society, it was only after the Big Bang deregulation that stock markets started to move away from people having to process trades in shares towards a new, fully digital system. Initially, the innovation was seen through the prism of an old profession catching up with technology and the theory was that it would reduce transaction costs, make data more available, and widen the group of people able to engage in the stock market.

However, the devil was in the detail of the unintended consequences of this shift. Although computer models had been used since the 1950s to analyse the stock market and to try to understand whether a stock was correctly priced, during the 1990s, firms started to use signal theory to extract patterns and information from data, not to see if the stock was accurately priced, but to try and predict any future price movement. The parallel rise of the EMH, which posits that the market reflects the true price based on all information available to it, meant this strategy did not seem illogical but

did make the market more reflexive and unstable. This led to the start of algorithmic trading. The accuracy of the predictions made under these kinds of models reduced rapidly over time. Whereas those analysts looking to understand the fundamentals of a stock through looking at the data to ascertain whether it was correctly priced could use that data for days or weeks to make effective trades, the data provided by signal theory 'had to be acted on almost immediately.'⁷⁰ This requirement to act immediately made computers the obvious choice to execute the trades.

In the early years, the development of computer-based trading was led by mavericks who wanted to subvert the system, which many thought was corrupt, by releasing information out into the open for anyone to use. It is certainly ironic that it was, as characterised by expert Scott Patterson, the 'bandits, pick-off artists, professional scalpers exploiting regulatory loopholes and ethically challenged'⁷¹ who were responsible for this trend and created the first really 'lit' market where everyone could see for free not only the best buy/sell orders but all the orders behind those as well. In reality, though, the benefits of the transparency could not be realised by human investors: all this information could only be effectively utilised by computers.

Long Term Capital Management (LTCM) was the first of many Icarus-like attempts to harness the power of what became known as algorithmic trading. In the mid-1990s, the fund made huge amounts of money on the global bond and derivatives markets by using an arbitrage strategy, which attempted to exploit differential pricing of stocks in different locations. When competitors started to imitate their strategies and models, it forced LTCM to innovate further, by going into the

far riskier equity markets as well as emerging bond markets like Brazil and Russia, leading to \$4.7 billion in losses in just four months, their downfall, and eventual bail-out.⁷²

Few within the system really understood the impact of this new form of trading and those who did were generally busy designing their own trading algorithms. This meant that there was little or no control over this new trend in trading. Indeed, the trend was to work to achieve ever-increasing speed with firms competing for each microsecond of advantage (it takes 500 microseconds to blink) over each other. Each microsecond advantage could be worth more than \$100 million if properly exploited.⁷³ This turned each second into an eternity in which millions of individual trades could be executed by a single computer. In the UK about 30% of equity market volume is traded by HFT, higher volumes than in Europe, but significantly behind the USA.⁷⁴ In a relatively short space of time, and without any meaningful oversight or strategic plan, the market had changed dramatically. From now on a significant percentage of trading activity would be based on decisions by computer algorithms without any intention of holding the stock and providing any mid- or long-term capital. Their sole aim would be to exploit an opportunity to extract value as an intermediary.

This left the role of the trader very different from what it was just a few decades ago. 'Instead of making order execution decisions based on valuation models or in the course of making a market or facilitating client orders, traders now use trading strategies based on algorithms to arbitrage differences ... and take advantage of liquidity, or lack thereof.'⁷⁵ An article in *Bloomberg Online* noted: 'We may never return

to primary reliance on fundamental analysis and computer-aided trading. Chartists and algorithmic traders now rule the day, and computers now do battle against one another's algos.⁷⁶

HFT was brought into mainstream consciousness with the flash crash of 6 May 2010 where in a matter of just a few minutes the Dow Jones lost almost 9% of its total value. Within 20 minutes it was all over and prices had returned to normal. The crash was triggered by competing algorithms trading huge volumes of stock in the 20 minutes of the crash. Analysis after the fact showed that 2 billion shares had been exchanged worth a staggering \$56 billion with some trades executed at highly irrational prices as low as a penny and as high as \$100,000.⁷⁷ Although a flash crash on this scale has not yet been seen again, market watchers are now seeing as many as a dozen mini-flash crashes a day, perhaps affecting only a single stock.⁷⁸

The exchanges, rather than protecting the medium- and long-term investors who had been key to the market functioning, were encouraging HFT traders to trade larger and larger volumes. Dan Mathisson, the doyen of electronic trading, confirmed this when he stated to a packed conference hall of HFT elite that 'the policies of today's exchanges cater to the needs of high-volume short-term opportunistic traders, the pick--off artists.'⁷⁹ They do this in many ways from the manner in which their pricing system works, especially the maker/taker fee structures,⁸⁰ to offering preferential services, especially around the location of HFT servers close to market servers to offer a speed advantage. These kinds of developments move us ever further from the ideal of the shareholder allocating their capital to sound businesses for productive investment

based on the fundamentals of a company's performance. Instead, equity markets are becoming dominated by speculation and arbitrage. Eric Hunsader, an expert in HFT and recently given a \$750,000 whistleblower award from the Security and Exchange Commission (SEC), goes much further and claims, that the market is 'absolutely positively rigged' and that 'it is rigged on many different levels in many different ways.'⁸¹

HFT traders are able to outmanoeuvre all other investors by buying the desired stock when the algorithm detects a buy order pushing the price up or selling when it detects a sell order. In the current market, it is no longer possible to make a move without computers potentially detecting it and affecting the price. Although each trade only makes a tiny amount of money, when done millions of times large profits can be generated. The potential impact in the long term for things like our pensions will be significant as profits are gradually shaved away. Charles Schwab argues that HFT has '...run amok and is corrupting our capital market system by creating an unlevelled playing field for individual investors and driving the wrong incentives for our commodity and equities exchanges.'⁸²

As the full potential of HFT begins to be realised, it has become clear that the HFT tail is now wagging the equity market dog and that the interest of other investors and companies are being sacrificed in the process. HFT has further divorced trading in stocks from the fundamental performance or prospects of a company while creating new opportunities for financial capital to extract value from the system rather than channelling the investment of additional capital into productive investment.

The full transformation from maverick idealistic computer hackers wanting to subvert the market to algorithmic traders that are in some sense controlling the market occurred within 30 years and has helped usher in another development: dark pools.

Dark pools

Dark pools are alternative trading systems that are to a large extent unregulated, although this may be changing.⁸³ Orders that are entered are not displayed to other market participants but are matched anonymously against contra-side orders. Then, once executed, they are publicly announced. 'The new wave of dark pools epitomizes a driving force in finance as old as time: secrecy.'⁸⁴

In some sense, the dark market is a return to the old way that the market, pre Big Bang, worked in that the general public only became aware of the trades done after the fact, i.e. once they were published. It is therefore ironic that, despite transparency and breaking the old boys' network being two of the primary motives for moving away from the old system, the end result of the advancement in electronic trading, specifically HFT, has been a return to secrecy and privileged access to information and trades.

Reasons for creating dark pools were logical, although undesirable, given the state of the current market. Large institutional investors had always risked moving the market when trying to buy or sell large volumes of a specific stock. There were well-established strategies for dealing with these large orders that brokers had been running since the early days of the market. The emergence of HFT meant these strategies no longer functioned, since the algorithms could detect the large

order, even if it was divided into lots of little orders. The institutions therefore looked for another mechanism to protect them against moving the market: dark pools.

What started out as providing a solution to a small subset of orders has grown so large that dark pools now account for a significant portion of total trading volumes. Today, about 15–18% of all trades are conducted in dark pools.⁸⁵

There is widespread agreement that the migration of too much trading to dark markets can significantly damage the quality of the lit markets by harming the price discovery process as well as increasing the opacity of market data. There is also a fear that the evolution of dark markets is creating a two-tier market in which only those with the right connections or trading balance can access the best prices.⁸⁶ All this leads to a general mild erosion of confidence in the market. In recognition of these risks, the EU has implemented the Markets in Financial Instruments Directive II (MiFID)⁸⁷ to try to exert some regulatory control and oversight of these markets and to try to push as much trade volume as possible into the lit market.⁸⁸ It should not be necessary to adopt such risky mechanisms as dark pools in order to circumvent the negative repercussions of the rise of HFT. Adopting dark pools more widely could fundamentally undermine people's confidence in the market with the main beneficiaries being the financial institutions who act as intermediaries and operate the dark pools.

Who are the shareholders? Changes in patterns of ownership

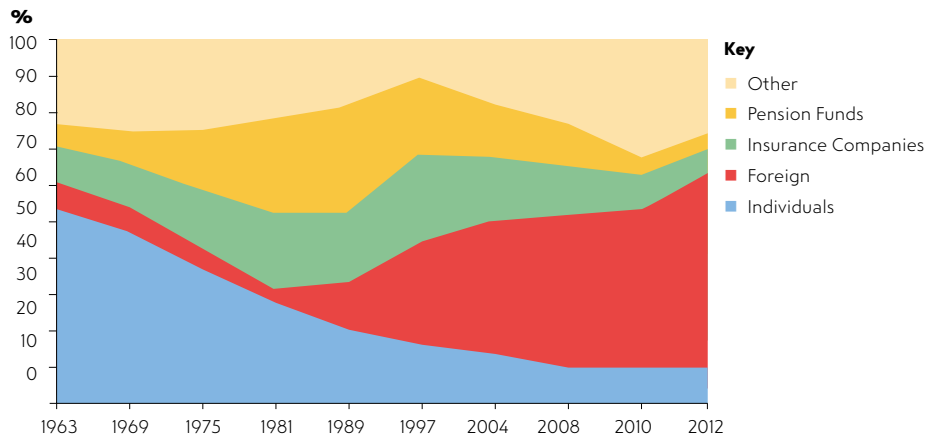
In parallel with the rise of ultra-short-termist, high-frequency and algorithmic traders, other trends in the evolution of equity markets have meant that long-term investors – those who should theoretically act as a counterweight of engaged ‘owners’ rather than disengaged ‘traders,’ thus keeping shareholder oversight anchored in the long-term interests of companies – are less and less equipped to play this role. In practice, this has meant that companies are increasingly accountable not to real people with a real stake in the company’s long-term success, but to an abstract ideal of shareholder value maximisation – usually embodied in today’s share price.

In the first half of the twentieth century, the number of individuals, companies, and financial institutions holding shares increased and the major issue was that it had become increasingly hard for these disparate groups of shareholders to exert their influence over the management team of corporations. Since the 1960s, there has been a shift from individual to institutional share-ownership: individual ownership has

shrunk from about 50% in the 1960s to less than 10% today.⁸⁹ UK pension funds and insurance companies’ share in ownership of UK listed companies is also in decline, from over 50% in 1990 to less than 15% today,⁹⁰ with foreign institutions, such as hedge funds, sovereign wealth funds, and overseas pension funds, taking an increasing share (Figure 1).⁹¹

Of course, many of the institutions who now hold shares still ultimately represent thousands of individual savers with private pensions or other savings products. It has been argued that this has the latent potential to make shareholder capitalism much more democratic – with the growing importance of private pensions, which UK workers are now being automatically enrolled into, meaning that ‘we are all shareholders now.’ But for the moment at least, much of the real power is in fact increasingly concentrated in the hands of a relatively small number of asset managers who hold shares on our behalf. For instance, BlackRock, the world’s largest asset manager, has \$4.5 trillion in assets under management.

FIGURE 1: OWNERSHIP OF SHARE CAPITAL IN UK’S QUOTED COMPANIES 1963- 2012



Source: ONS 2013

As the Kay Review noted, this situation poses ‘principal/agent’ problems of its own which have profound implications for the way the system functions. The ordinary people who own shares through pension funds and other investment vehicles and who ultimately shoulder the risk of company losses ‘have little direct communication with, involvement in, or indeed knowledge of, the firms in which they are investing.’⁹² Meanwhile, the asset managers employed by their pension funds or insurance companies to invest on their behalf are typically assessed based on quarterly performance relative to a benchmark based on the performance of the market as a whole or of other similar managers.

In other words, those with the power to hold companies to account are incentivised only to maximise the share price in the next quarter, regardless of whether this is achieved at the expense of the company’s long-term prospects (e.g. by cutting costs, under-investing, or ignoring risks) – and thus of the savers they represent.

This rise of intermediation has created a powerful self-reinforcing cycle of short-termism, complexity, and opacity in capital markets. In addition to asset managers, companies and savers are now typically separated by a long chain of intermediaries including fund-of-fund managers, investment consultants, custodians, proxy voting advisors, and others. As the London School of Economics (LSE) economist Paul Woolley has noted, these intermediaries have a powerful incentive to push their clients towards more complex investment strategies and to increase portfolio turnover (i.e. trade stocks more frequently), enabling them to extract more value in the form of fees

and transaction costs, even if these strategies are not delivering better value for savers – let alone generating wealth in the economy as a whole. In turn, this growing complexity exacerbates the information asymmetries between investment intermediaries and their clients, heightening the potential for rent extraction.

All this is not merely conjecture. In 2011, the average externally managed pension fund tendered for nine different managers, compared to just three a decade earlier.⁹³ From 2002 to 2007, pension funds’ payments to intermediaries rose by an estimated 50%,⁹⁴ while annual real returns on pension investments averaged just 1.1%, significantly lower than preceding decades.⁹⁵ In 2010, an equity manager who underperformed the market by 2% could still expect a 20% increase in fees.⁹⁶

In other words, we have gone far beyond the traditional charge that shareholder capitalism benefits investors at the expense of wider society. The current model of shareholder capitalism benefits neither companies nor ultimate investors, but serves largely as a machine for extracting wealth to the enormous network of financial intermediaries who sit between them.

3.3 FLAWED MODELS, FLAWED MARKETS: CHANGES IN INVESTMENT APPROACH

One final factor contributing to the disconnect between capital markets and real economic activity has been the theoretical models being used by investors – in particular, MPT and EMH.

Modern portfolio theory and diversification

MPT is an approach to assessing and managing portfolio risk which emphasises diversification and uses the historic volatility of securities prices as its key metric for predicting future risks. Since the 1970s, it has legitimised investment strategies previously regarded as speculative and therefore inconsistent with fiduciary investors' duty of prudence. It has also promoted excessive diversification in the name of managing risk. MPT is often interpreted by institutional investors as a dictate that investors should be maximally diversified: evidence shows that the benefits of diversification tail off dramatically above around 30 stocks,⁹⁷ but the average institutional investor will now hold thousands. A side effect of this 'dehumanisation' of investment relationships has been to accelerate the erasure of values and ethics from the language of investment, exacerbating the dominance of Milton Friedman's doctrine that companies exist to make money, irrespective of any moral considerations.

This level of diversification affects shareholders' *ability* to hold companies to account effectively, but also raises more fundamental questions about their *incentive* to do so. Conventional theory holds that shareholders should be in charge because it is their capital that is potentially at risk. However, analysis by Martin Wolf of the *Financial Times* points out that in modern equity markets, shareholders can relatively easily mitigate this risk by holding a diverse portfolio of stocks and, thanks to the liquidity of the market, are able to divest their stock relatively easily at any time. This may lead shareholders to have a larger than expected risk appetite, since they can avoid the worst of the downside risk⁹⁸

(although, as discussed later, this can prove to be an illusion, if shareholders suddenly find themselves exposed to 'non-diversifiable' systemic risks, such as a financial crisis or catastrophic climate change). Ultimately, the risk of company failure falls most heavily on employees, customers, and suppliers who are not easily able to diversify that risk. Employees in particular will find it hard to hold a portfolio of jobs, and cannot buy or sell one job for another. Local communities and the welfare state are also affected since they are often left to pick up the bill for the externalities caused, as well as being left with increased demands on social security resources.

This has two important implications. First, it suggests that the system, as currently designed, may tend towards excessive risk-taking, since those with the greatest ability to absorb risk are given sole controlling rights over corporate strategy. Secondly, it calls into question a key plank of the rationale for this governance model. In a world where huge and highly diversified institutional investors trade shares in thousands of companies, hundreds of times a day, the argument that a shareholder has more at stake than a worker, that they have more to lose from an individual company's success or failure, and that companies should therefore be run in their sole interests, looks less and less credible.

Efficient markets or the lemming standard?

The problems with MPT are closely bound up with those of the EMH, which holds that all relevant information about a company's prospects is necessarily reflected in its share price. But markets are only as clever as the sum total of their participants. Paradoxically, blind

acceptance of the EMH has led many investors to assume they do not need to bother undertaking fundamental analysis of companies' value, but can simply construct optimal portfolios using complex mathematical models based on share price data. The obvious problem with this is that it relies on somebody, somewhere, doing the fundamental analysis which would allow the company's real-world prospects to be reflected in its share price. The more investors rely on efficient markets rather than their own judgement to assess company value, the more self-referential and fragile the system becomes – with share prices less and less grounded in economic fundamentals, and more and more subject to violent shocks, as investors herd in and out of particular assets.

The 2008 financial crisis exposed many of the shortcomings of MPT and the EMH. It showed that assessing portfolio risk based on historic data was woefully inadequate, blinding investors to systemic financial risk and even exacerbating it by encouraging investors to 'herd' into the same assets with the same over-optimistic assessments of their safety. Just as banks and ratings agencies were lulled into a false sense of security by flawed models which told them their loan portfolios were safe, the same was true of investors whose models told them their portfolios were safely diversified, even as the financial system began to collapse around them. Yet because of a lack of alternatives and the absence of a strong constituency for change, MPT remains the dominant paradigm for institutional investment – despite growing acceptance that it is not a good representation of reality.

3.4 CONCLUSION: FROM INVESTING TO TRADING

All these trends have combined to produce a system that increasingly treats shares as paper assets to be bought and sold to generate speculative profits rather than as a source of long-term investment and profit. Investment strategies focus on timing these trades to profit from changes in the share price, or on designing portfolios to match the performance of other asset managers engaged in similar strategies. As John Kay has pointed out, this kind of asset price arbitrage is a zero-sum game: one investor's gain from buying low and selling high is exactly mirrored by another investor's loss, and no new wealth has been created by this process, let alone social value.⁹⁹ For one person to win, another must lose – and increasingly, the only real winners appear to be the army of financial intermediaries who control and perpetuate this merry-go-round. Genuine investors focused on selecting companies with promising long-term prospects, such as Warren Buffett – who famously commented that 'our favourite holding period is forever' – are in an increasingly small minority.

4. THE IMPACT OF FINANCIALISED CAPITALISM

The trends described in Section 3 have made our capital markets more and more unfit to meet the economic, social, and environmental challenges of the twenty-first century as they increasingly become a vehicle for value extraction at the expense of the productive economy. The foundations of the equity market are starting to crumble as it ceases to be a net source of investment capital for companies, drives societal inequality, and increases the pressure on economic growth.

Instead of channelling capital into sustainable and productive economic activity, our savings are increasingly being funnelled into speculative trading – exacerbating financial instability; threatening jobs and investment; and holding back the transition to a regenerative, low-carbon economy. Shareholder capitalism is purported to be the most powerful engine for mobilising productive investment the world has ever seen. But, thanks to the combination of increasingly complex and speculative financial markets and the relentless pursuit of shareholder value, the system is not just failing to deliver this goal: it is actively undermining it.

4.1 ECONOMIC IMPACTS: FINANCIALISED CAPITALISM HOLDS BACK INVESTMENT

It is increasingly well established that the vagaries of the stock market are acting as a barrier to long-term productive investment by companies. As the Kay Review noted, UK equity markets are no longer a significant source of new capital for companies: they are largely secondary markets engaged in (increasingly speculative) trading of existing securities.¹⁰⁰ But equity markets are not only failing to pump money *into* companies: they are increasingly sucking money *out* of them, for example via dividends and share buybacks. In addition, corporate managers are increasingly incentivised to prioritise strategies which can boost the share price in the short term rather than those which could deliver long-term value.

Although not unique in the world, corporate investment, in both the UK and the USA, is at an all-time low. This is not for want of money to invest: corporations are sitting on large cash

piles, totalling \$2 trillion in the case of the USA, and £500 billion in the case of the UK.¹⁰¹ But this money simply is not being invested: instead, it is being returned to shareholders or used to buy back company shares. The latest and most widely publicised example is the demise of BHS which saw the ‘owner’ Philip Green extract over £500 million from the company during his tenure only to finally sell the company in 2015 for £1. In 2005, his wife, who legally owned all the shares in the parent company, received a huge £400 million dividend payment amounting to more than the year’s profit.¹⁰²

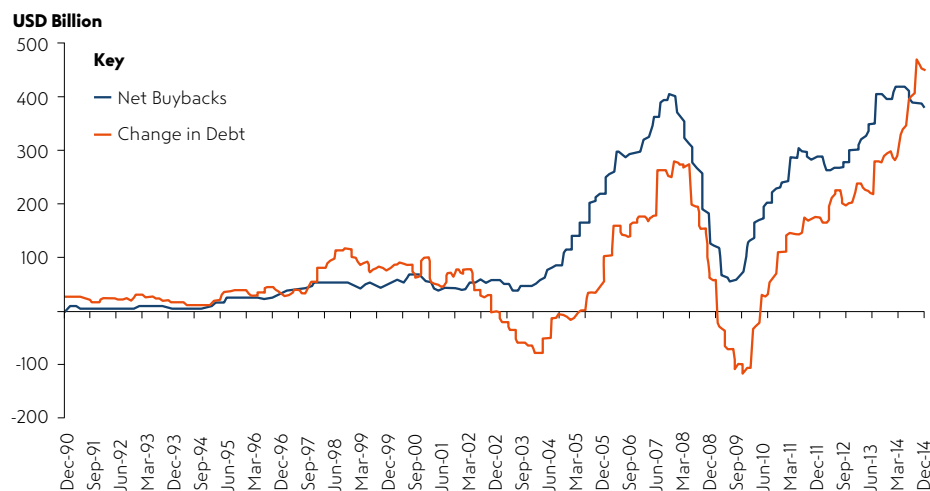
But this is far from an isolated incident of exploitative management: it is becoming increasingly endemic to the way corporate Britain is managed. For instance, in 2012, BAE Systems was sitting on a £2.1 billion cash pile, but in the previous two years had cut 22,000 jobs while returning £2.2 billion to shareholders. Meanwhile, oil services company Amec ended 2011 with £521 million of cash and instigated a £400 million share buy-back programme.¹⁰³ In addition, where companies do not have the cash available, there is strong evidence that debt is being used to purchase the shares (Figure 2) as the additional cost to the

company of acquiring the debt, at the current historically low rates, can be outweighed, at least in the short term, by improved investor sentiment as earnings per share increase.

Companies like Royal Dutch Shell and Cobham Engineering have been increasing their dividends annually for decades. Although dividend payments can be a sign of a healthy company, the pressure on directors to maintain or increase the dividend payment in order to protect the share price has changed corporate behaviour. Andy Haldane’s analysis of US corporate dividend payments shows that in the nineteenth century, payment of dividends rose and fell along with market conditions as would be expected. In the vast majority of years, companies either did not change the level of the dividend or they decreased it. However, since 1980, dividends have been on an almost inexorable rise with near continuous increases: ‘The short-term quest for smoothing shareholder returns has come to dominate pay-out behaviour, almost irrespective of profitability.’¹⁰⁴

In the USA, a similar story can be seen. US companies are borrowing record amounts to buy back their own shares. Of course, since this does nothing to

FIGURE 2: BUY-BACK FUNDING FOR US COMPANIES



Source: Societe Generale

change the company's fundamental value or long-term prospects, it serves only to generate asset price bubbles which eventually burst (e.g. the recent downgrade of Exxon).¹⁰⁵ For instance, Apple has a cash pile of \$200 billion being held offshore, yet has borrowed billions of dollars in recent years to finance share buybacks to boost its stock price – since servicing the debt is cheaper than repatriating the cash and paying tax on it.¹⁰⁶ This kind of short-term financial manipulation is increasingly taking the place of real investment and innovation. The US pharmaceutical industry has cut 150,000 jobs since 2008, mostly in R&D, focusing instead on financial engineering and outsourcing to boost short-term profits.^{107,108}

There is good evidence that this under-investment is a direct consequence of the dynamics of the short-term shareholder value maximisation and financialised capitalism discussed in Section 3. For instance, in one US study, 55% of US financial executives surveyed said that they would avoid initiating a very positive Net Present Value project if it meant falling short of their earnings targets for the current quarter. In turn, the study found that 'managers are interested in meeting or beating earnings benchmarks primarily to influence stock prices.'¹⁰⁹ In another study, Asker *et al.* found that publicly held companies are investing at around half the rate of privately held companies, and suggested that this is because the returns from such investment will not be realised on a quarterly basis.¹¹⁰

The UK Commission on Ownership concluded, based on consultations with company directors, that the market for corporate control (i.e., mergers and takeovers) is the ultimate driver

of these short-termist management strategies. The Commission's Chair, Will Hutton, has claimed that 'British companies think, strategize, innovate and invest their way to success far less than their competitors in different ownership regimes. They know the penalty for one wrong move is to be taken over.'¹¹¹ This is a dark parody of what the market for corporate control was supposed to achieve – namely, that the sanction of bad management being forced out would make companies focus relentlessly on becoming as efficient, productive, and dynamic as possible. Again, it is clear that the system is not only failing to deliver the things it was supposedly designed for, but is actively undermining them.

4.2 SOCIAL IMPACTS: FINANCIALISED CAPITALISM IS DRIVING INEQUALITY

These trends also help to drive trends towards growing income and wealth inequality. First, the explosion of financial intermediation and the potential for rent extraction via information asymmetries in this sector has made it enormously profitable and has generated correspondingly high pay at the top. It is in some ways ironic that the finance sector itself is one place where employees appear to have done much better than shareholders and that this has contributed to ratcheting up of top pay in other sectors.¹¹²

Secondly, there is growing evidence that attempts to align executive pay with shareholder value have mainly served to drive up pay (and reinforce the short-term mentality) through the proliferation of annual bonuses and stock options.

Thirdly, the wage share has been decreasing relative to the profit share since its peak in 1976 of 76%, falling to just 67% in 2014.¹¹³ The UK has performed well in the past as a wage-led economy, which means that increased wages lead to more economic activity than increases in corporate profits. The pressure to maximise the share price as well as increased financialisation has contributed to the downward pressure on wages. The resultant profit-led economy has not only failed to boost economic growth, as was the goal, but has worsened inequality and hampered overall economic development.¹¹⁴ Rising inequality and the fall in the wage share also exacerbate financial instability since people have to take on more and more debt to buy what they need and want.¹¹⁵⁻¹¹⁷

Companies are also moving in to the provision of credit and other financial services which have become more profitable than their core business of making products or providing services. Airline companies routinely make more money from hedging on oil price movements than they do from selling plane seats, even though this undermines their core business by exacerbating commodities price volatility and can expose them to huge and sudden losses if they make bad bets.¹¹⁸ Another example is GE Capital, the finance arm of General Electric, which has over 35,000 staff and made \$10.8 billion on assets of over \$514 billion contributing over 40% of the groups profitability between 2000 and 2015.¹¹⁹ This increased financialisation leads to a higher prospect of financial crises through increased exposure to debt.

4.3 ENVIRONMENTAL IMPACTS: FINANCIALISED CAPITALISM CONTAINS A GROWTH IMPERATIVE

Short-termism and environmental degradation

There is a fairly familiar criticism that short-term shareholder value maximisation exacerbates environmental destruction, not only because it precludes the consideration of environmental issues for their own sake, but also because the financial risks associated with environmental degradation tend to crystallise over longer time periods. For instance, a 2009 survey of asset managers identified short-termism as one of the key barriers to addressing climate risk, with one saying:

*'The most significant barrier is the imbalance between the relatively short term horizons of mainstream investment analysis and the relatively long term nature of the material business impacts of climate change.'*¹²⁰

An often-cited example of this dynamic is the BP Deepwater Horizon oil spill. Oil analyst Tom Bergin has documented extensively the incentive structures which enabled the disaster by 'encourag[ing] managers to put short-term financial goals ahead of the long-term health of the business and its employees,' including by cutting costs and neglecting essential maintenance and safety measures.¹²¹ Of course, as well as being an environmental catastrophe, the Gulf of Mexico spill was one of the most financially calamitous events in BP's history, causing it to lose two-thirds of its market value and cancel its dividend for the first time since World War II.

Some might argue that it is not the job of corporate governance (which can be thought of as the ‘internal’ regulation of company behaviour) to ensure that environmental risks are managed, and that this is a job for governments to do via ‘external’ regulation. However, the very same logic which has helped to produce our dysfunctional variant of shareholder capitalism is also undermining the ability of governments to play this role, as advanced economies (particularly the UK) aggressively pursue deregulation and promote voluntary action by companies as a more economically efficient way of achieving social and environmental goals.¹²² The problem with this logic is that our economies are dominated by large listed companies that are increasingly deterred from addressing environmental risks even when it is in their own long-term financial interests to do so. This combination may yet prove fatal to our ability to address urgent environmental risks, such as those posed by climate change.

Ecological limits and the growth imperative

Modern financialised capitalism may also place more indirect pressure on the environmental systems which ultimately sustain all economic activity, by creating an imperative to maximise growth at any cost. The Capital Institute contends:

‘The exponential growth of compound investment returns and, by extension, the exponential growth of the economy’s material throughput demanded by the financial system, has positioned our global economy on a collision course with the finite physical boundaries of the biosphere.’¹²³

In other words, pressure from investors to maximise realised returns, and the stock market’s tendency to value share price growth over stable cashflow, contribute to a relentless pursuit of growth at company level. There is much debate in the literature about whether it is possible to decouple growth in economic activity from growth in resource use and environmental degradation^{124,125} – but, as we have seen, modern shareholder capitalism certainly has no inherent mechanism for ensuring such decoupling.

The growing financialisation of welfare and public services means that this potential contradiction has serious implications. For example, advanced economies like the UK are increasingly relying on private pensions invested via capital markets to provide for their ageing populations. In turn, these private pensions rely on high levels of investment return, particularly in equities, to translate savers’ contributions into an adequate retirement income. The reliance on rising asset prices to sustain returns implies either high levels of growth in the real economy – which may be environmentally unsustainable – or ever larger and more destabilising speculative asset price bubbles and crashes. Conversely, recent modelling by the Actuarial Profession has found that if growth is constrained by environmental resource limits, the consequences for pension funds could be catastrophic.¹²⁶

Even in the absence of severe environmental constraints, today's sluggish global growth and low interest rates are already creating problems for institutional investors. Among other impacts, there are warnings that this could be inflating a corporate debt bubble in developing countries as investors look further afield in the search of higher yields.^{127,128} If such trends continue, we could find ourselves facing a toxic cocktail of financial instability, environmental destruction and pensioner poverty. At present, these linkages are poorly understood, and much more research and policy debate is needed if developed economies are to successfully reconcile the demographic, environmental, and economic challenges we face. Certainly, relying on our dysfunctional capital markets as the main mechanism for achieving this reconciliation is a strategy that carries serious risks.

5. REIMAGINING THE CORPORATION AND EQUITY MARKET

While these problems are increasingly well recognised, the response so far has been to tinker at the margins of the current system – or to hark back to the way companies were run before the Big Bang and the advent of shareholder value, often through rose-tinted spectacles. But the scale of the system’s dysfunctionality, and the scale of the changes it has been subject to, suggests that we may not be able to recapture a mythical past. Instead, we may require a new model of the corporation and equity market.

The evidence discussed so far raises two fundamental questions. First, does the shareholder corporation as it stands still make sense as the dominant institution for organising production – or should we be promoting a more diverse range of ownership and governance structures, and/or considering changes to company law? Secondly, does it still make sense to rely on equity investment as the best way of mobilising risk capital – or do we need to develop new instruments and levers better suited to the kinds of long-term investment we need to, for example, transition to a low-carbon economy? In other words, is it enough to make incremental changes to existing systems and institutions, or has the landscape changed so dramatically that we also need to envision new systems and new institutions?

These are huge questions, and this report does not pretend to have all the answers. However, we suggest that they are questions which deserve much wider debate. In the remainder of this section, we review some of the current proposals and models which may offer fruitful avenues to explore.

5.1 A NEW TYPE OF CORPORATION

The shareholder-centric corporate model that has come to dominate the modern economy is no longer fit for purpose. We need to rethink the purpose, governance, and ownership, or more accurately control, of corporations.

Some have harked back to the supposedly halcyon days of managerialism in the early twentieth century, when directors were relatively unaccountable to shareholders and yet seemed to run their companies taking into account a wider range of stakeholders and concerns than they do today. There are certainly good elements to take from this era

of corporate capitalism, such as the regard for long-term sustainability over short-term interests and the lack of financialisation, but the real question is *who* (or what) they should be accountable to. If, as we have argued, it is misleading to think of shareholders as the principals on whose behalf directors must act, then whose agents are they? What forms of governance and accountability can best align the interests of company directors with those of society?

These new models should look at changing the nature of shareholding as well as considering the potential of alternative forms of ownership. The new shareholder model should be such that those holding controlling rights in corporations are committed investors, in it for the medium to long term, and concerned about ensuring the long-term success of the company. Companies also need to better define their purpose and values and report regularly against these goals including the social and environmental impacts of their operations. Furthermore, they need to embrace different forms of ownership that are less focused on ensuring that the needs of an increasingly diversified and fickle investor class are met. These changes would enable companies to act in the interests of a wider group of stakeholders and the long-term interests of society.

Purpose and governance

As explored in Section 2, corporations used to be institutions that had a specific public purpose, like building a bridge, a university, or a canal, with profit being at most a secondary outcome. The modern corporation could not be more different. Today, many directors see it as their primary goal to maximise short-term profits in order to derive as much shareholder value as possible.^{129–131} Companies

mainly report on narrow financial measures of their performance like net profit, earnings per share, or revenue per employee. This needs to change.

Many modern corporations exist almost solely to create returns for their shareholders. However, if we are to stop climate chaos, achieve the sustainable development goals,¹³² or reduce inequality, then we need corporations that produce goods and deliver services that have a beneficial impact on society, the environment, and people. Corporations should be incentivised or required to take into account the impact of their activities on a wider range of stakeholders, as theoretically envisioned by the Companies Act 2006. This could be achieved in part by requiring a corporation to publicly state their purpose and how they intend to achieve it. Importantly, there also needs to be regular reporting on progress and mechanisms to hold directors to account. A number of different initiatives and proposals are trying to address this, such as the Purpose of the Corporation initiative¹³³ and the B-Corporation movement (B Corps)¹³⁴ and Trust Firms¹³⁵ (discussed below), and the Economy for the Common Good,¹³⁶ which we explore at the end of this section.

B Corps

B Corps are for-profit companies certified by the non-profit B Lab [a global non-profit organisation with offices in the USA, Europe, South America, Canada, Australia, and New Zealand] to meet rigorous standards of social and environmental performance, accountability, and transparency.¹³⁷ In order to be certified a B-corp, the company must go through an evaluation of its current business practices, such as governance, how employees are treated and rewarded, its impact on the local community,

positive and negative environmental impacts, and customer value. It must achieve a score over 80/200 in the test, which is validated by B Labs. To maintain standards, 10% of B Corps are audited in detail every year.

As well as passing the evaluation, the company must also embed its principles into its articles to ensure that it is focused on achieving its purpose/values for the long term. In practice, most make a commitment to a 'triple bottom line' approach to business, which has been around for over three decades without delivering substantial change. For a typical business, this is likely to mean inserting a clause which states that it exists to promote the success of the business for the benefit of its shareholders but also to have a material positive impact on society and the environment.

Launched in the UK in 2014 with 62 initial members, it is a fast expanding network that has over 1700 businesses registered. B Corps recently won an important victory with their first preferential tax treatment when a law in Philadelphia used B-corp certification to define eligibility.¹³⁸

Objective standards can be useful to everybody. To consumers they can be an easy way to identify 'good businesses' to patronise like 'fair trade', 'fair tax', or 'organic.' For impact investors, it can be a sign that this is a good company to consider investing in. As in Philadelphia, policymakers can use the certification as a tool to implement incentives. Finally, companies can use them to help find like-minded companies to drive sustainable supply chains.

A critique of the B-corp movement has been that it seems to present itself as the only way for directors to take account of the wider stakeholder community. In fact, legally, directors can already do this within existing structures, although in practice many do not. The rebuttal from proponents of the B-corp model is that it places additional official requirements on directors to take wider stakeholders, the environment, and society into account rather than this being at their discretion. However, the reality is that the decision-making process within corporations is largely a function of the company's culture and processes rather than the law – this is no less true of the new B Corps.¹³⁹ For example, it is generally impossible to sue companies for not following one of their purposes, which makes the extent of the true obligation debateable. This could potentially be addressed through a change in law.

Trust firms and stakeholder boards

In his book *Firm Commitment*, Colin Mayer advocates for companies to be set up as what he terms 'trust firms.'¹⁴⁰ A trust firm has a board of trustees, who have nothing to do with the day-to-day running of the company, but instead have as their primary objective to ensure that the company is fulfilling its purpose and values. A prominent UK example is the BBC which is run in accordance with a public charter (i.e., purpose) and has a trust in place to ensure that the corporation abides by its public service obligation and is not subject to undue political interference. The Sparkassen, the German network of local public savings banks, is also owned in trust for the public benefit. The New Economics Foundation (NEF) has proposed that a similar structure be adopted for a UK local banking network formed by breaking up the Royal Bank of Scotland.¹⁴¹

This model proposes that the company, ideally in collaboration with its stakeholders, sets the values and purpose which should guide its actions and decisions. These should go beyond metrics looking at financial measures. The board of trustees is then solely responsible for ensuring that the company has stated values and principles, and meets them. This kind of board provides oversight that is not about actively running the company but guiding and monitoring the fulfilment of its purpose. This structure overcomes some of the confusion in the role of non-executive directors to provide both oversight and advice. By ensuring that the board is properly selected or elected, it can function with considerable independence while being committed to representing stakeholders broadly. A properly functioning board can provide the external credibility that a company is really meeting its defined purpose and values.

As well as proposals to shift the goal of corporate activity towards a purpose-driven stakeholder model, there have also been calls to change the composition of boards within existing structures. The TUC¹⁴² and High Pay Centre have, for instance, called for mandatory employee representation on company boards, just as Theresa May did briefly before reneging following pressure from company executives.¹⁴³ This mimics some of the best features of the German ‘corporatist’ model, where a two-tier board structure and network of works councils gives the workforce a strong voice. This model ensures that workers can exert some influence on decisions around remuneration and strategy, something that is unusual in the UK context. In Germany, the rules have been codified, meaning that all companies with over 500 workers must establish a supervisory board that has at least one-

third worker representation. This board then has the right to set the levels of executive pay and bonuses as well as hire and fire the executive board that runs the company.

The provisions set out in section 172 of the UK Companies Act 2006 have not ushered in a new era of enlightened shareholder value. There are a number of issues with trying to legislate for directors' decision-making processes. It is very hard to draft text that everyone is happy with and that is flexible enough to be applied to all decisions made by all directors and yet precise enough that it really does hold them accountable. The provisions of section 172 focus on the former rather than the latter. Ultimately, it is unlikely that a prosecution could be brought under the Act. Legislation can act as a beacon establishing the principle that directors are expected to make decisions in the interests of the company and its wider stakeholders. Ultimately though, as Professor Andrew Keay has argued, the ‘legislation leaves [stakeholders] without a remedy’ for any perceived breach and ‘a right without a remedy is worthless.’¹⁴⁴

5.1.2 OWNERSHIP AND CONTROL

The other major challenge that any new model of the corporation will need to overcome is the pressure to give overriding priority to meeting shareholder demands. A culture appears to have emerged within companies that these demands need to be met, irrespective of the nature and extent of the shareholders’ commitment to the company. This section assesses whether there are any ways we can manage these pressures and looks at whether other models of ownership can help to achieve a more rounded stakeholder-centric company decision-making structure.

Drawing on the famous maxim about taxation, Colin Mayer has stated that there should be 'no representation without commitment.'¹⁴⁵ At present, the interests of all those who hold shares need to be taken into account, with additional weight given to large shareholders, since they all have the same voting rights based on 'one share one vote.' This means that despite the very different commitment to the future long-term prosperity of a company that a high-frequency trader has, compared with an institutional investor, which holds the share for many years, both are treated equally for the purpose of corporate control.

French company law bestows double voting rights on those who hold shares beyond two years. In some countries, like the USA, companies can issue different classes of shares, with some coming with voting rights and others not. This system allowed the founders of Google to issue a large quantity of shares without losing overall control of the company. These two developments, although positive, have limitations. The French case only rewards past action and does not reflect future commitment, whereas the different classes of shares are generally not used to reward long-term investors, small and large, but to allow powerful and visionary founders/owners to maintain control of the company while benefiting from the ability to sell shares.

It should be possible to differentiate between those shareholders with long-term commitment to a company and those without, and to reward the former with differentiated control of the company. In order to satisfy this, Colin Mayer has proposed that if an investor makes a commitment for ten years, then their vote should be valued at ten times a one-year commitment. Those not prepared to make any commitment to the firm would still

be free to trade and own shares but would have no voting rights. This is an improvement on the examples cited earlier, because it rewards future commitment and better aligns the interests of company to the long term by vesting the most votes in those with the longest commitment to the company.

This kind of reform could be particularly important to ensure that present efforts to promote more active share-ownership – for example, through the UK Stewardship Code – do not unintentionally reinforce short-termism and exacerbate the very problems they are attempting to solve.¹⁴⁶ The same could be said of reforms to the investment chain itself to ensure that theoretically long-term investors actually behave in a long-termist way. These issues are now discussed.

Alternative forms of ownership

As well as thinking about ways to re-orientate companies away from shareholder value towards the long term, it is also vital to consider different forms of ownership. The UK's focus on shareholder ownership has led to a uniformity of structure and focus, with most large firms facing the same (often perverse) incentives and therefore likely to behave in similar ways and encounter the same problems at the same time. This is particularly apparent in the banking sector, where NEF has previously presented evidence that stakeholder ownership models perform better on a range of measures, and that countries with more diverse ownership structures have been more resilient to financial shocks.¹⁴⁷⁻¹⁴⁹ We briefly cover three alternative forms of ownership and governance in this section: co-operatives, employee-owned companies, and mutuals.

The ownership structure of cooperatives appears to have a profound effect on the priorities and performance of these institutions.^{150–152} This alternative form of ownership and control places incentives on managers to maximise long-term value to the members of the cooperative. The resulting focus should lead to an inclusive approach to customers and a prudent approach to risks and managing capital, which can have positive benefits for the economy as a whole as well as for individual customers. Cooperatives frequently aim to maximise ‘customer value’ rather than profitability. There are three main types of co-ops: membership co-ops, of which the Cooperative Group¹⁵³ is one of the highest profile examples, where anyone can join and take part in the running of the organisation; producer co-ops, where individuals and businesses, not necessarily themselves coops, work closely together, usually within a sector; and workers’ cooperatives, such as SUMA Wholefoods. Under this model all employees become part of the cooperative. Workers’ co-ops can be better at ensuring the long-term benefit of the members since there is an increased interest in the collective long-term success of the company, not just to provide a financial return as an owner, but also a secure good job as an employee.^{154,155}

Majority employee ownership, either in the form of personal share ownership or indirectly through a trust, as in the case of the John Lewis Partnership, can also deliver tangible business benefits: employee-owned companies achieved higher rates of sales growth and job creation during the recession than shareholder companies.¹⁵⁶ They also created new jobs more quickly and were at least as profitable as their counterparts.¹⁵⁷ Employees are

normally well represented at board level, ensuring wider stakeholder voices are heard and acted on. Although there is a huge variety of employee ownership structures, in general this model makes it harder for power and financial reward to be retained by a minority at the very top.¹⁵⁸

Mutuals operate successfully at different scales and in varying sectors, from large health insurance firms to local credit unions, but keep the same underlying principle: only those who contribute to and use the services of the organisation can benefit from them. Mutuals can set their priorities based on those set to be impacted by their actions. The UK’s mutual sector, mainly made up of financial institutions, was decimated by the demutualisations of the 1980s; for example, most former building societies were absorbed into highly leveraged shareholder-owned banks, many of which subsequently collapsed in the crisis of 2008.¹⁵⁹

All three of these organisational structures share a focus on those who run or use the service. While that is a benefit in terms of engaging with concerned members, who generally are more interested in the long-term prospects of the organisation, they have one thing in common: they are unlikely to access mainstream finance. Rather than raising money through bonds or capital markets, they generally do so via loans and reinvesting revenue. Although this can make it more difficult for them to expand and grow, they are also more at liberty to reinvest profits, since they are not under the quarterly pressure of announcing results to expectant and increasingly fickle shareholders. In a context where shareholder-owned firms are under-investing, this suggests that promoting more diverse ownership structures could actually boost long-term

investment, as well as enabling the interests of a wider stakeholder group to be considered.

Redefining economic purpose: economy for the common good¹⁶⁰

The Economy for the Common Good (ECG) is a concept proposed by Austrian economist Christian Felber.¹⁶¹ Much as earlier proposals sought to refocus the goals and values of the company, the ECG seeks to redefine the purpose of the whole economy away from just increasing revenue and profit towards contributing positively to the common good. The ECG derives this core purpose of the economy from numerous constitutions around the world which specifically state it as being the common good, such as those of the USA, Germany, and Columbia.

The ECG takes a different approach to instilling purpose and values from the examples mentioned earlier, which seek to lock in a specific self-determined purpose for the company. It has defined 17 different areas of impact that go towards creating a Common Good Balance Sheet, including ethical supply chain management, ecological design of products or services, income distribution within the company, and contribution to the local economy. Each of these areas is scored, based on objective criteria that have been established by the wider ECG network of experts and interested parties.

The ECG does not force a company to adopt any particular policy, value, or practice, nor does it require any specific annual improvements. It requires only that a company complete the balance sheet and make the results public. This can by itself provide benefits to consumers by making available valuable information about

a company's practices in order to inform their purchases. Requiring all companies (not just corporations) to complete an ECG balance sheet, and then making the information publicly available on products via a traffic-light colour system, could encourage consumers and investors to shift their spending and capital towards companies that score highly overall, or just in the areas that are important to that person.¹⁶² QR technology, which allows smartphones to access information by scanning a visual code, could also be used to allow consumers to see the whole balance sheet.

If this were the full aspiration of the ECG, it would be easy to dismiss and criticise the model as being incremental and insufficient because relying on consumers to make active choices based on complex information often has limited success. But the ECG's vision for a new economy is much more profound and encompasses reforms to the tax, banking, and international tariff systems to financially reward those companies which perform well under the ECG matrix while burdening those that perform badly. This means that in a fully operational ECG economy, a company that scores well would also receive rewards, relative to those companies who perform badly. A high-scoring company could expect to pay a relatively lower level of corporation tax, be subject to low or no customs tariffs, get bank loans at low/no interest, and get preferential treatment in a portion of public procurement contracts.¹⁶³

This offers one possible mechanism for policymakers to reward companies that contribute positively towards society and the environment as well as the economy.

5.2 REFORMING LIMITED LIABILITY IN THE LEGAL SYSTEM

The legal system has to balance between providing certainty (to enable people to make investments in businesses in a secure fashion) and a certain level of discretion (to allow for the attainment of justice in particular cases). Limited liability is one of those elements that helps to provide legal certainty to investors, while the ‘corporate veil’ doctrine – which allows the courts to remove the limited liability of shareholders and hold them fully liable for the actions of a corporation under certain circumstances – aims to mitigate the worst of the injustices.

The legal system cannot eliminate liability but in fact shifts it around society and the economy. In this case, the liability is moved from shareholders, who cannot lose more than they invested in shares, to creditors. This dynamic leads to creditors demanding higher interest rates on loans.¹⁶⁴ Although there is some theoretical justification for removing limited liability by default, it is no longer a practical solution due to its entrenched nature, and the fact that there is a convincing argument that passing on all liability to shareholders could discourage some socially useful investments with considerable downside risks.

Nonetheless, there is a good case for some reform of the legal system within which limited liability sits. First, we should consider whether it makes sense to vest limited liability on those individuals with control rights, and secondly, we need to ask how limited liability should be applied across complex corporate structures.

Separating limited liability and control rights

As our analysis has shown, one of the deficiencies of bestowing the same stakeholder group, shareholders, with both limited liability and exclusive control rights is that it fails to align risk and reward. Those with most to gain have almost no downside risk, as outlined in Section 3, and are therefore likely to encourage short-term thinking along with increased risk taking.

An interesting corporate structure that emerged in the Middle Ages in France is the *société en commandite* and, although rare, some still exist today. Under this structure, the shareholders are treated differently in terms of the extent of their liability, depending on whether they are seeking to exert any control over the business. Active managers are fully liable for the actions of the company, whereas investors are protected by limited liability in return for playing no active role in the company. Any evidence of active intervention would make the investor fully liable whether they be an individual or a company.

This structure, whose benefits would only be realised if coupled with a transition towards stakeholder governance as the default, helps to align control and risk by trying to ensure more long-term thinking and different appreciation of downside risk for investors wishing to actively manage the company. This is an area that is in need of further detailed research to fully understand its applicability to today’s companies.

Corporate veil and limited liability for complex corporate structures

The standard narrative assumes that shareholders are individuals who require the limited liability corporate form to engage in the business. It did not consider the situation in which one company controls another, often quite directly. There is a good argument for not applying limited liability to a wholly owned subsidiary of another company.¹⁶⁵ In complex corporate structures, where a company may be owned by another company or by a group, reforms of the corporate veil doctrine may offer the best way forward.

Today the evidential burden placed on a complainant wishing to pierce the corporate veil is too high. Even when natural justice would be served by lifting it, UK courts have been extremely reluctant to do so. This means that companies are incentivised to create complex corporate structures to avoid full liability and shield parts of their business. Even if it can be shown that the intention of the parent in setting up the child was to avoid liability, this is not enough to lift the veil.¹⁶⁶

A better system would be to have a presumption of liability for the parent company unless it can prove the independence of the subsidiary. This presumption would affect voluntary and involuntary creditors differently. Involuntary creditors are those who become creditors to the business without wanting to, for example being a tort victim of some action by the company, while voluntary creditors are all those to whom money is owed by the company, and

who engaged willingly. Although for voluntary creditors it is likely that full liability would, in most instances, be extinguished with a signed contract, it would still be an improvement on the system we have today, because this would at least make explicit the liability arrangement and offer creditors a potential choice. The big difference would be for involuntary creditors who would have to be compensated by the parent company unless they could prove beyond a reasonable doubt that the subsidiary was independent. This would be a fundamental change and provide a real chance of those affected by the actions of a company to seek some form of redress.

The change would be best introduced by an Act of Parliament but could also be introduced through case law. It was through a judicial decision that liability was extended in the Bhopal case in India which created the offence of 'strict enterprise liability'.¹⁶⁷ Existing UK case law would make this difficult and would require the Supreme Court to overrule a previous decision, which it is at liberty to do.

There is an interesting debate as to whether the offence should be 'strict', meaning that there is no defence once the offence is proven (as in the Bhopal case) or whether there should be a duty of care relationship, in which case the plaintiff would have to show that the parent company had been negligent in allowing the child company to act in a certain way. Clearly the objective of internalising risk is best met by strict liability.

A version of this proposal was put forward by Berle in the 1940s when he proposed the concept of enterprise liability which seeks to reconstruct the economic boundary of the corporation.¹⁶⁸ This concept was then applied in UK case law in 1970, termed single economic unit theory, in judgements by Lord Denning, one of the most famous English twentieth-century judges.¹⁶⁹ Although he sought to apply the principle to hold corporations liable, he did not offer any theoretical justification for using the principle and so the doctrine was never followed by subsequent judges. There is also strong support for 'the use of single economic unit theory to hold a corporate parent liable for its wholly owned subsidiaries.'¹⁷⁰ A shift in this direction towards full liability being re-introduced under certain circumstances could have a significant impact on the behaviour of corporations and shareholders if they thought that they might be fully liable for an action carried out by the entity.

5.3 NEW WAYS OF ORGANISING INVESTMENT

The preceding sections explored some of the suggestions for orientating the purpose and governance of corporations to ensure that they performs beyond merely maximising shareholder return. We briefly examined how alternative company structures with very different ownership and control models can also help to break organisations into a new behaviour paradigm. In addition, reform of the legal framework could help provide the necessary incentive for companies and shareholders to start to proactively change their behaviour.

In this final section, we look at how we might reshape the equity market so that it can help entrepreneurs and business people to create the twenty-first-century businesses that we need to address the social, environmental, and economic challenges that we face. We look at potential mechanisms to control HFT, new investment opportunities that are not reliant on growth or short termism, as well as the need for a state investment bank SIB.

Managing HFT trades

Many agree that the worst behaviour of some players engaged in HFT and dark pools needs to be curtailed. For instance, Charles Schwab did not mince his words when he said: 'High-frequency traders are gaming the system, reaping billions in the process and undermining investor confidence in the fairness of the markets. It's a growing cancer and needs to be addressed.'¹⁷¹ Deciding what to do, however, is complicated. There is an inherent conflict between those wishing to buy large volumes of stock and do not want to see the price react to their buying, and market-makers who want their prices to reflect actual supply and demand. A distinction is now emerging between those using HFT strategies to act as market-makers, and want quote prices to remain stable to profit from the spread and are generally welcomed by exchanges, and a more predatory strategy involving generating profits from volatility. However, it is hard to distinguish between the two strategies. As Brad Katsuyama, CEO of Exchange IEX, noted: 'Everyone purports to be a market-maker.'¹⁷²

A couple of exchanges, Aquis in Europe and IEX in the USA, are trying in very different ways to create environments that welcome the HFT market-makers but foil the strategies of predatory HFT traders. Neither exchange is trying to make a judgement as to whether a particular trading firm is desirable or not; instead they are establishing rules which mean that, in theory, the predatory strategies will not work.

Aquis decided to ban HFT traders from placing anything other than passive orders, meaning that they can only supply orders and are not allowed to act on another trader's bid or offer.¹⁷³ This enabled a doubling of its share of public European stocks that were traded on its platform in the month since the rule was introduced in February 2016.¹⁷⁴ Although the exact reason for the increase cannot be known, there is speculation that as more people become aware of the impact of HFT strategies, outlined in Section 3, investors will proactively try and find locations where they are not liable to have their orders intercepted, or front run, by HFT traders.

IEX, the exchange made famous in Michael Lewis's book *Flash Boys*,¹⁷⁵ has a similar desire to remove the advantage of HFT strategies but uses a different strategy. IEX has implemented a 350-microsecond delay (about 1/1000th of the time it takes for the human eye to blink) to level the playing field. As well as challenging the predatory HFT model, it also calls into question the lucrative middleman business of shaving additional microseconds off connection times. This is done by exchanges who sell premium locations close to the order-matching engines, those engaged in building new connections between locations, and the companies selling the latest equipment. The SEC recently approved IEX as an official Exchange after a number of

delays. This has led to the volume on the exchange growing rapidly as well as seeing a number of other benefits.¹⁷⁶

Another strategy is building a form of financial transaction tax into HFT. This proposal can be seen as entirely complementary to and in the spirit of the proposal by Nobel economist James Tobin for a Tobin Tax that would charge a small percentage fee on all currency transactions in order to slow down the market or 'throw some sand in the wheels of our excessively efficient international money markets.'¹⁷⁷ The most promising proposal in this regard is to place a small fee not on the actual trade of shares itself but on the quote. The reason for this is that the HFT revolution has seen an increase in trades but an exponential increase in quotes. To give an indication: in 1999, with computers and algorithms already playing a key part in the market, there were in the region of 1000 quotes per second. By 2013, this has risen to an astonishing 2,000,000 per second with about 95% of those emanating from HFT.¹⁷⁸ Every hour, HFT outfits are sending 6.84 billion quotes with cancellation rates that can easily exceed 95%.¹⁷⁹ This 'quote stuffing,' as it is known can, cause prices to fluctuate or cause other machines to slow momentarily as they try to interpret the data.¹⁸⁰

A proposal to address this is to implement a small fee to cancel a quote. Given the volumes of quotes that are cancelled, the fee could be quite small per quote meaning that it would have little impact on traditional investors but a huge impact on HFT. The SEC and Commodity Futures Trading Commission (CFTC) both considered this in 2013 and it has the support of investment luminaries such as Charles Schwab and Walt Bettinger.¹⁸¹

A final proposed reform is changing or repealing the maker-taker fee structure that has emerged recently in many exchanges around the world and causes distortions in the way markets operate.¹⁸² Maker-taker fees offer a rebate to those who provide liquidity, and charge customers who take that liquidity. The chief aim of maker-taker fees is to stimulate trading activity within one exchange over another. However, there is concern amongst established money managers who want to see the structure eliminated, or at the very least severely curtailed, because they believe that the rebates that can be earned on certain exchanges incentivise broker dealers to find the trading venue based on the potential rebate, rather than being in the best interests of the client.¹⁸³ Research showed that by the late 2000s on the NASDAQ, the profit derived by HFT on stocks had turned negative, at least when only taking into account the spread between the buy and sell prices. The only way that certain HFT outfits were making any profit on deals was by pocketing the fees due to them.¹⁸⁴

Dark pools also need to be brought into the light. Regulators are already considering whether to regulate these alternative trading venues more closely and their activity, structures, and rules should be more openly available.¹⁸⁵ Dark pools accounting for almost 20% of US equity trades makes it very hard to have full confidence in the information available in the lit market. Others advocate for minimum order sizes to ensure that dark pools are really only used for the initial purpose: to stop large orders from moving prices.¹⁸⁶

Making equity markets work better

Of course, as we have seen, the problems with the functioning of equity markets extend far beyond the rise of HFT; structural dynamics also mean

that theoretically long-term investors who should act as a counterweight to this frenzied short-term trading can in fact exacerbate short-termism. A number of recent proposals have been undertaken by key actors to improve the functioning of equity markets and realign them with the long-term interests of companies and investors, through either regulation or voluntary action. For example:

- Clarifying pension funds' legal responsibilities so that they behave in a more long-term and responsible way, rather than incentivising their managers to focus on quarterly returns and ignore long-term social and environmental risks.¹⁸⁷ The Law Commission has recently clarified that pension funds do not have a duty to maximise short-term returns, as is often assumed; that they should take account of material long-term environmental and social risks, including systemic risks; and that they can consider the ethical views of their members.¹⁸⁸ ShareAction, a registered London-based charity that promotes responsible investment, has called for amendments to the relevant investment regulations to put these changes on a statutory footing and make sure pension fund trustees are clear on their legal responsibilities.¹⁸⁹
- Making investment intermediaries more accountable to the savers whose money they manage, for example by introducing stronger legal duties to act in savers' interests (particularly in the case of contract-based pension providers, who are likely to become increasingly major players under automatic enrolment, yet do not have the same duties to savers as traditional trust-based pension funds),¹⁹⁰ greater transparency (e.g. on fees, portfolio

turnover, or the exercise of voting rights); or rights for savers to hold their agents to account directly.¹⁹¹

- Encouraging pension funds and other institutional investors to radically simplify their investment strategies and change the way they hire and remunerate managers, including by changing the way they construct mandates.¹⁹²
- Applying stronger rules to limit and/or manage conflicts of interest among insurance companies, asset managers, and investment banks, and promoting mutual and non-profit models in the investment sector itself – to overcome the fundamental conflict between a listed company's duty to its shareholders and its fiduciary duty to prioritise the best interests of the people whose money it manages.¹⁹³

These are all valuable proposals – and all of them and more will likely be necessary to protect the individual savers whose money is currently caught up in our dysfunctional capital markets, particularly as many low-income savers with low financial capability are being pushed into the market via automatic enrolment, taking on significant investment risks with inadequate consumer protection. But are they enough? If equity markets are no longer acting as a major source of new capital, and indeed if the demands of the stock market are actually holding back investment and innovation within large listed companies, do we also need new vehicles for connecting investors and companies which are more suited to long-term, sustainable business models?

Private equity: a red herring?

In recent years, the private equity lobby has been vocal in offering itself as a solution to the growing dysfunctionality of the stock market. They point out that private companies are investing at twice the rate of public companies, and suggest that private equity ownership removes the imperative to focus on short-term movements in the share price. But of course, private equity is far from immune from either short-termism or from agency problems.

First, private equity business models generally rely on selling the company on again at a specified date to realise a profit – in theory by making it more efficient and effective, but in practice often through cost-cutting and other strategies designed to maximise the company's value at the sell date, regardless of whether this is best for the company or society in the longer term. Private equity owners can also extract value from the companies they own through asset stripping: again, the model creates little incentive to care whether this might damage the company in the long term.

Secondly, private equity managers charge extortionate fees to their clients, with little evidence that this is matched by the value they create.¹⁹⁴

Thirdly, private equity buyouts are often financed by loading previously successful companies with debt – as in the case of the pharmacy Boots and a number of premiership football clubs.¹⁹⁵ This business model is only viable because the interest on this debt can be deducted from taxable earnings in the UK and most other countries. In contrast, the dividend payments and retained profits that flow to shareholders are taxed in most

places.¹⁹⁶ This use of leverage makes it comparatively easy for private equity managers to realise a profit, but has come under severe criticism for its impact on the companies themselves.

Evergreen Direct Investment

Some thinkers are beginning to experiment with new vehicles to take investment back to basics through simple partnerships between investors and companies that sidestep both the vagaries of the stock market and the less attractive features of private equity, and the intermediaries that go with them. In the USA, the Capital Institute is developing a model it calls Evergreen Direct Investment (EDI).¹⁹⁷ Based on equity payback structures common in real estate, it involves negotiated partnerships between investors and mature, stable-cash-flow businesses, in which the investor negotiates a share of the stream of the enterprise's cash flows on an ongoing basis to realise their target returns over time. Like private equity, it enables a close and direct relationship between investors and companies, and insulates enterprises from the pressures of short-term shareholder value maximisation. Unlike private equity, it does not rely on the sale of an enterprise to realise returns, the extraction of excessive fees by external private equity managers, or the loading up of companies with excessive debts.

The Capital Institute argues that EDI addresses head-on many of the problems that plague investment via securities markets:

- It is based on long-term cash flows rather than short-term asset price movements, giving investors and companies the incentive and opportunity to focus on long-term corporate performance.

- It dramatically reduces the chain of intermediation separating asset owners from the companies in which they invest – thereby eliminating layers of cost and misaligned interests.
- It is a logical extension of John Kay's call for a return to 'relationships' over 'transactions and trading',¹⁹⁸ based as it is on direct, negotiated relationships between investors and companies. As such, it also offers the opportunity to reinject investors' values into investment decision-making.
- It is suited to stable cash flows that are undervalued because the market values growth over resilience – and is therefore potentially a more suitable vehicle for the transition to an economy based on sustainable prosperity.
- It is consistent with much more concentrated 'stewardship portfolios' in which companies are chosen and overseen based on their long-term prospects, by investors with a meaningful stake in the business, and an understanding of the responsibilities of genuine ownership.

State investment banks

Being designed for mature businesses, EDI still does not tackle the question of how best to mobilise investment in new industries which require large injections of capital, for example to finance innovation in green technologies. Ultimately, we suggest the state must play a role here. As economist Mariana Mazzucato has argued, the 'entrepreneurial state' has in fact always played a key role in financing such paradigmatic shifts towards new technologies, being well

placed to invest in important and experimental research which may not have an immediate commercial application, and to provide 'patient capital' for long-term projects.¹⁹⁹

The UK is unusual in the extent to which it rejects a role for the state in this respect and has no SIB. Development banks are playing a key role in financing ecological projects that may be deemed too risky for the mainstream financial sector. For example, in 2012, the share of SIBs in the 'climate finance landscape' was 34% (the highest share of any single type of actor), compared to 29% for project developers (including state-owned utilities), 19% for corporate actors, 9% for households, 6% for all types of private financial institutions, and 3% for executive governments (investments from governmental budgets).²⁰⁰

Some SIBs, such as the China Development Bank, the Brazilian Development Bank (BNDES), and the German Development Bank (KfW), are particularly active in promoting green energy investments.²⁰¹ For example, the bulk of BNDES's green investments goes to renewable energy projects, which amounted to USD \$3.5 billion per year on average during 2008–2013 but also includes investments for the renewal of public and cargo transport fleets (more fuel-efficient vehicles); green agricultural projects; waste, water, and forest management; energy efficiency; and climate change adaptation projects.²⁰² By taking on major investments that are deemed initially too risky for commercial players, these organisations can be seen to be market-makers in the green energy sector.

To achieve the scale of investment needed to transition to a low-carbon economy and to meet the challenges of climate change and energy security, the UK needs to develop an industrial strategy that focuses public and private resources on long-term investment of the sort the stock market, as currently structured, is not able to provide.



CONCLUSION

We should be looking at alternatives to the model of shareholder corporations by promoting a diverse range of ownership and governance structures, considering changes to company law, and developing new instruments and levers which are better suited to the kind of long-term and sustainable investment we need.

OUR RECOMMENDATIONS

Changing the ownership, control, and purpose of the corporation

- Corporations should be incentivised or required to take into account the impact of their activities on a wider range of stakeholders.
 - Corporations should be required to state their public purpose openly and regularly report on how they are fulfilling this.
 - Interesting initiatives like B-Corps or The Purpose of the Corporation Initiative should be developed and expanded.
 - Corporations should be encouraged to consider the Trust Firm model, which offers a way for companies to commit to acting in the public benefit.
- The current structure of ownership and control of companies must be challenged and changed by insisting that there can be 'no representation without commitment.'
 - Holders of shares should be required to make commitments to the future of a company. Their voting rights should be dependent on the length of their commitment. Those uncommitted to the company could still hold and trade shares, just not exert any active control.
 - Other forms of ownership such as co-operatives, employee ownership, and mutual ownership should be incentivised and re-invigorated.

Reforming Limited Liability to ensure protection and align risk and reward

- Limited liability should be extinguished for wholly owned subsidiaries of parent companies, unless they can prove that the subsidiary is truly independent.

- More research should be carried out on the potential benefits of aligning control rights to increased liability – meaning that only those exerting no influence on the company could benefit from full limited liability.

New ways of organising investment

- Predatory high-frequency trading (HFT) activities must be restrained without destroying benefits.
 - Rules governing exchanges should be changed to curtail the predatory aspects of HFT.
 - HFTs could be allowed only to place passive orders and an ultra-small delay (350 millisecond) could be implemented.
 - With HFT cancelling 95% of the almost seven billion quotes sent per hour, a form of financial transaction tax should be added to quotes that are submitted to exchanges but subsequently cancelled.
 - Dark pools should be regulated and controlled.
- Making equity markets work better
 - Pension funds' legal responsibilities should be clarified through legislation so that they behave in a more long-term and responsible way.
 - Investment intermediaries should be made more accountable to the savers whose money they manage, through a legal duty to act in savers' best interests, increased fee transparency, and a right for savers to hold them to account directly.

- Stronger rules to limit and/or manage conflicts of interest within the investment chain should be created and applied.
- New investment vehicles need to be created to allow companies to receive investment that avoids many of the problems of the equity market.
- Investors could partner with mature stable cashflow businesses to engage in equity payback structures common in real estate.
- To mobilise investment in new businesses and industries, a State Investment Bank should be created.

The growing disquiet over the functioning of shareholder capitalism in all quarters is an indication of a system in crisis. But to date, acceptance of the scale of the problem has not been matched by the solutions on offer.

This report has set out a way forward for reforming shareholder capitalism. It has shown why we have to question whether shareholder capitalism is really the best way of organising investment and production in the twenty-first century. We can and must do better. Let's take the first steps towards a better, fairer, and more sustainable economic system right now.

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