

Reimagining Capitalism

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Abstract: Capitalism needs to be reimagined. Over the last century, capitalism lost the moral moorings originally envisioned by Adam Smith. For Smith, both moral virtues and self-interest are inherent in human nature. Today, we supercharge the value of rational self-interest but reject the virtues. While capitalism has a dark side, it simply needs reimagining, not removal. Many suggest the public sector should step up and take a more dominant role. My answer may be surprising. We restore virtues by having virtuous corporations in the private sector, that is, we build companies that care about their utility.

“When we begin to put justness on par with profits, we get the most valuable thing in the world (...) our humanity.”

Paul Tudor Jones II, Founder of the Tudor Investment Corporation and the Tudor Group, TEDx Talk, April 2015

Changing the scope of the debate and going back to basics

In the past, criticism on capitalism ranged from disagreeing with its principles to disagreeing with its particular outcomes. However, currently, the debate on the economic principles has practically ended, leaving a world where almost every country embraces some form of capitalism with varying degrees of competition, public intervention and ownership, regulation and international trade. Consequently, opponents center their arguments against this system mostly by

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reasoning that the already evident consequences of its dynamics (*e.g.* inequality of opportunity and output, rising environmental damage) will eventually lead to social unrest and political instability in every nation, making capitalism unsustainable in the long run. Recipient of the Nobel Memorial Prize in Economic Science Joseph E. Stiglitz famously argued in his book, *The Price of Inequality*, that divisions in today's society are endangering the idea of a prosperous future. Similarly in his book *Freefall*, Stiglitz propounds that rapid economic growth has become environmentally and socially unsustainable in the current capitalist system. This argument is well intended, but also requires further analysis. The capitalist system indeed needs to be reimagined but not because of its problematic outcomes, the result of deeper issues, but because some assumptions on which capitalism are based are no longer present in modern society.

Yuval Levin starts his chapter, "Recovering the Case for Capitalism" in his book *National Affairs*, by stating the recent economic-financial crisis had it all: "reckless investors, careless lending, irresponsible borrowing, wild speculation, charlatan financiers, signs of under-regulation, retirees losing their life savings while Wall Street fat cats got their bonuses, and even the sight of Alan Greenspan apologizing to a congressional committee for keeping the reins too loose." It is a sad but true reality. This portrayal describes not only the banking sector, which Levin is probably blaming for the crisis, but also the unmeasured ambition of American society. This description defines what I will call 'capitalist man': one who is self-interested, but more characteristically, someone who does not have discipline, in the words of Levin, a diabolical mix of Babylonian decadence and Philistine vulgarity.

Adam Smith, who is often described as the father of capitalism, based his views of political economy on his view of human nature. Although human beings are fundamentally self-interested they can be guided towards sympathy and benevolence because they also desire attention, praise and recognition. In other words, Smith assumes the desire for approval opens a door for moral education, which shapes behavior and channels human appetite towards the public good. The type of education to which Smith refers is not about persuading people to be virtuous but about helping them to develop moral sentiments in society. In his first book *The Theory of Moral Sentiment*, Smith describes these moderate virtues as: prudence, restraint, frugality, sobriety, honesty, civility and reliability. With these virtues, capitalism is thought to be the more efficient mechanism for wealth production. However, in a world where these virtues are not present, capitalism becomes ineffective, unfair and even dangerous.

What went wrong? Adam Smith underestimated the challenges of sustaining moral norms during times of economic prosperity, but more importantly, the

individual Smith put in the center of capitalism, full of virtue, is not one who exists today in modern society. Smith was mistaken when he assumed that capitalism can produce sufficient authority to educate and dignify human beings. The virtuousness of the person of his time more than anything else emerged from institutions such as family, religion and tradition. Smith was likely not counting on these institutions losing their importance over centuries and certainly never thought about how that loss might impact human virtuousness.

As Levin states, properly understood, the case for capitalism is a case for national wealth as a moral good but also for moral virtues. The latter is the real challenge of reimagining capitalism today. Losing Smith's virtues, undoubtedly in great part due to capitalism itself, is the reason why capitalism is no longer sustainable and needs to be reimagined.

The good news: capitalism creates not only the disease but also the cure

Can the 'capitalist man' change? Undeniably, trusting in the institutions that once were up to task cannot re-educate 'capitalist man'. In general, for the millennial generation, family is a commitment to avoid. Tradition is, in the words of Woody Allen, the illusion of permanence and religion is apparently declining in moral influence. As a consequence, modern society needs to create a new instrument if it really intends on reimagining capitalism. The answer to this dilemma may be surprising. Capitalism not only created 'capitalist man', but also the institutions that can reshape the current capitalist system: the private sector.

Let's take for example, Starbucks. Part of the company's commitment, as expressed on its mission, is to leverage its scale for the good. This mission translates to offering health-care and shares to partners and investing in environmental sustainability. This decision has put the company in a vulnerable situation and generated strong reactions. Different groups either criticize or idolize the firm. In this context the question is whether Starbucks is unique or a harbinger of the future? Are private firms going to reshape capitalism? Why would they do so?

(i) The reality is changing: choosing between for-profits and non-profits is not necessary anymore.

Modern society loves to characterize people as either villains or heroes. This oversimplification is a way to handle what otherwise is complex reality: almost everyone is a villain and a hero in some way. In this novel of tyrants and innocents, big corporations and CEOs are given the role of the oppressors, and their actions are constantly questioned.

However, the reality is that in the new millennium, firms do not have to choose between being profitable and being good anymore. It used to be if someone wanted to make a difference in the world, she joined a nonprofit. If she wanted to make money, she launched a business. The lines are now blurred. Currently, several non-profits are run like fast-growing startups and numerous traditional companies are being built around social missions. In 2010, Maryland was the first US state to blur the line between for-profit corporations and non-profit organizations by creating a new legal entity: the [Benefit Corporation](#). Since then, almost twenty states have followed suit. Benefit Corporations are committed to providing social or environmental benefits while still showing a healthy bottom line. More than a thousand companies have embraced this new form of doing business, including big brands like Warby Parker, Patagonia, Etsy, and Ben & Jerry. This trend is here to stay. For-profit firms are another vehicle to change the world. Meanwhile, [Beespace](#), newly located in New York, is utilizing the tech incubator model to help launch the next generation of non-profits.

Following this line of thought, Scott Anthony, a Managing Principal at the innovation consulting firm [Innosight](#), opened his keynote speech at the Creative Innovation Conference last year by saying: “If you want to change the world, join a large corporation”. Anthony went even further while addressing graduates stating: “it is okay to start your own company or join a nonprofit [if you want to change the world], but you can also consider working for a large corporation, they are uniquely positioned to do things that only they can do.”¹

Larry and Sergey, two average students at Stanford University, started to explore the mathematical properties of the Word Wide Web. ‘BackRub’, as the project was called, checked backlinks to estimate the importance of different websites. After a while, encouraged by their mentor, the two students asked their friend, Susan, for use of her garage in Menlo Park as a playground to work on the idea for a little bit longer. In the end, by misspelling the word “googol” (the number one followed by one hundred zeros) while trying to communicate that the project intended to provide large quantities of information, the two friends founded Google and quickly changed the world.

Using the words of the Latin American author Jorge Luis Borges, Google become “the universe”²: large, weird, accessible, shocking, banal and essential. By sorting and ranking content and relevance, Google started to have the power of making information visible or invisible. In other words, it started to give people data that

¹ “Want to join change the world? Join a corporation” by Alli Rushdan, February 11, 2014. www.fastcompany.com/3026264/leadership-now/want-to-change-the-world-join-a-corporation

² “The Library of Babel” Jorge Luis Borges

³ <http://epistle.us/inspiration/godwillsaveme.html>

could become knowledge and, later on, wisdom. It gave people from all around the globe a voice. In the end, it became a means to level the playing field across countries. Before Google, developing economies were somewhat isolated, but Google gave them freedom, showing that information can be the start to solving very basic human needs. Can anyone argue that individual firms cannot contribute to solving the big problems while making loads of money after Google?

(ii) The business case behind this theory: achieving sustainability in the long term and meeting consumers' demand for transparency.

Almost every single day academics and scholars hear of companies that decided to do things differently and succeeded: Unilever, Triodos Bank, Southwire, United Stationers, to take a few. Every single time, these intellectual naysayers are skeptical about the rationale or motive behind the decisions. Moreover, they get stuck at a very controversial question: do the firms and CEOs deserve “a seat at the table” to change the world?

Two stories come to mind: the one about the faithful Christian³ and the one about the bumblebee.

The legend says that a long time ago, a terrible storm came into town and local officials sent out an emergency warning that the riverbanks would soon overflow and flood the nearby homes. A faithful Christian man heard the warning and decided to stay, saying to himself: I will trust God and if I am in danger, then God will send a divine miracle to save me. Soon after, the neighbors came by his house and said to him: we're leaving and there is room for you in our car, please come with us! But the man declined. As the man stood on his porch watching the water rise up the steps, a man in a canoe paddled by and called to him: hurry and come into my canoe! But the man said no again. The flood waters rose higher and higher and the man had to climb up to his rooftop. A helicopter spotted him and dropped a rope ladder. A rescue officer came down the ladder and pleaded with the man: grab my hand and I will pull you up! But the man still refused. Shortly after, the house broke up and the floodwaters swept the man away and he drowned. When in Heaven, the man stood before God and asked: Why didn't You come and save me? And God said: Son, I sent you a warning. I sent you a car. I sent you a canoe. I sent you a helicopter. What more were you looking for?

On the other hand, according to entomologist Antoine Magnan, who wrote in his 1934 book called *Le vol des insectes*, his scientific team had applied the equation of air resistance to bumblebees finding their flight was impossible. But in reality,

³ <http://epistle.us/inspiration/godwillsaveme.html>

bumblebees can indeed fly.

In other words, both stories address this dilemma of having firms involved in providing public goods: if it works in practice, do we need to know why it does work in theory? At the same time, what if the solution of our problems does not have the form and shape we were hoping for? Are we going to reject it?

The conversation around having firms at the table becomes irrelevant just by deciding not to answer the controversial question anymore. It is time to understand the business case behind private companies getting involved in social, environmental and political issues.

There are three different scenarios whereby the private sector can provide public goods, depending on two factors: (a) if the public good is relevant for the core business of the firm, and (b) if the public good is a source of competitive advantage for the company.

The first scenario, which I call the “Charity Scenario”, presents itself when the private sector receives a positive utility only from the mere act of doing good and nothing else. This means the public good does not create positive externalities for the core business or a specific competitive advantage. An example of this case is the business model proposed by Patagonia: “we don't give profit primacy over our other values, like building the best product or using business to implement solutions to the environmental crisis.”⁴ Basically, Patagonia makes corporate decisions based on what it believes is right without analyzing if the company gets any benefits from it.

The second scenario, called the ‘Single Utility Scenario’ exists when the firm gets direct utility from the public good, which means that it is relevant for the core business or for sustaining their competitive advantage. A clear example is when a firm provides training or education in one particular area because it benefits the company either in the short or the long term. For example, in Latin America, paper mills often need more qualified engineers than the market is actually producing. Thus foreign firms investing in the region frequently decide to offer training programs available to locals. Southwire is doing something similar with the ‘12 for Life’ educational program in Georgia, U.S. The leading manufacturer of wire and cable created in 2007 the 12 for Life platform to help students gain extra motivation to finish school after predicting a shortage in the future supply of

⁴ Rose Marcario, Patagonia’s CEO in “How Patagonia’s new CEO is increasing profits while trying to save the world.” by Drake Baer, February 28, 2014, www.fastcompany.com/3026713/lessons-learned/how-patagonias-new-ceo-is-increasing-profits-while-trying-to-save-the-world

qualified labor in the area. The program provides classroom instruction, job training and mentoring. The program has proven successful not only because it is reversing the school dropout trend in Georgia, helping develop the future workforce of the region, but also because it has allowed Southwire to hire 10% of its participants, providing results for its bottom line.

The last scenario, the ideal one called ‘Double Utility Scenario’, occurs when the public good is both relevant for the core business and it is also a source of competitive advantage. There are mainly three sources of this positive utility: increase in reputation, new sources or distribution channels and positive networking effects. The improvement in reputation can come from social (e.g. brand image) or relational sources (e.g. credibly within business partners). New sources and distribution channels occur when there is access to new resources (e.g. raw material) or markets (e.g. lock-in for emerging markets). Networking benefits exist when it creates rapport with relevant actors or access to policy makers. A Latin American example of this situation is when a Brazilian oil company invested in social areas to establish itself as a “Brazilian company”, improving its international reputation and getting out of reach for nationalization. In the U.S., Unilever has been engaging in projects with a similar logic. With its [Sustainable Living Plan](#), as the [Economist](#) puts it, “for the second time in its 120-year history, Unilever is trying to redefine what it means to be a virtuous company”. The Sustainable Living Plan aims by 2020 not only to reduce Unilever’s environmental impact and increase its social footprint, but also to double its sales and increase its long-term profitability, becoming an example of what a “good company” should do, improving its reputation and probably also opening new distribution channels. So far, the results have been overwhelmingly positive. A survey conducted by GlobeScan ranked Unilever as perceived to be the global leader in sustainability with the most comprehensive strategy for enlightened capitalism.

It is clear when the ‘Single or Double Utility Scenarios’ are present it is completely understandable and even commendable that a private company invests in public goods. This has to be evident even for those who argue that providing public goods indicate the firm misses the fundamental goal of the private sector: to maximize profits (*a la* Friedman). In the words of Carly Fiorina, former CEO of HP and a candidate for the Republican Presidential nominee: “It is in our profound, enlightened self-interest to ensure that we tap more talent in more markets, that we build more markets capable of buying and using and understanding our products and technology”⁵. Simply put, companies in these two

⁵ 2003 Speech at York University. www.hp.com/hpinfo/execteam/speeches/fiorina/schulich.html.

scenarios need to invest in public goods to be successful in the present and sustainable in the long term.

The ‘Charity Scenario’ is more complicated. There is a principal-agent problem with management due to the non-existent direct link between the core business of the firm or its capabilities and the good being done. It can be argued then, that this scenario is mostly a place for charity. However, it is helpful to keep in mind that with time, circumstances change and problems or public goods in one scenario can move towards other scenarios. For example, what if consumers start to demand private firms get involved in solving social, environmental and even political issues? It is evident, from extensive research, the level of confidence in public institutions, business and government has fallen to historic lows⁶. In this context, it seems consumers are demanding, now more than ever, transparency and trust. According to Schultz, CEO of Starbucks: “the consumer is going to recognize more than ever before that those companies that are doing the right thing to help are the ones that they’re going to want to support, (...) companies that reject this proposition, are going to be dismissed by the consumer”⁷. In other words, in this scenario, solidarity will soon become a competitive advantage on its own, and the ‘Charity Scenario’ will merge and mix with the one of the Utilities Scenarios.

To effectively measure how big this effect can be, Paul Tudor Jones II, founder of the Tudor Investment Corporation and the Tudor Group, among others founded a non-profit called Just Capital. Its mission is to help companies learn how to better operate by using public input to define “just corporate behavior”. Just Capital will conduct a nationwide survey of a representative sample of 20,000 Americans to learn the criteria consumers use to evaluate justness in corporate behavior. The American public gets a voice in this issue for the first time. By 2016 the non-profit plans to rank the thousand largest U.S. companies in an index called the Just Index.

(iii) The duty that comes with power

Finally, the reason why modern companies should have an impact on political decisions and create social solutions to pressing problems is because with power comes duty. Some of the characteristics exhibited by corporations (*e.g.* size, reach) are ideal to address some issues.

A recent study by Princeton University shows economic elites and organized groups representing business interests have substantial independent impacts on

⁶ <http://www.gallup.com/poll/1597/confidence-institutions.aspx>

⁷ HBS Case: Starbucks Coffee Company, Transformation and Renewal.

U.S. government policy. In contrast, average citizens and mass-based interest groups have little or no independent influence.⁸ In other words, Gilens and Page, coauthors in the research, use data to explain how the preferences of the average American literally do not matter in deciding political issues. Therefore, private companies need to fill the void in leadership created by the inefficient and short-term driven public sector. For example, Oprah Winfrey and Katharine Graham founded OWN Network and the Washington Post respectively to create channels for citizens to express themselves, giving them the chance to make a difference in the world via a private firm.

Closing remarks

‘Capitalist man’ can be a beast sometimes: destroying the environment, the planet, other species or even himself. Yet, this particular economic species can learn to care about others and to respect its surroundings. Adam Smith’s capitalism in the original form was supposed to do just that. Today the actor portrayed as the problem, the private sector, can play that role.

This analysis show that when private firms consider their own utility, understood as the benefit from sustaining a healthy core business or a strong competitive advantage, they face scenarios where it is advantageous to invest in what many call Corporate Social Responsibility (CSR). CSR is not about charity but it is about maximizing economic utility. The only necessary element to start to reimagine capitalism is, maximizing utility, properly understood.

During his speech at Georgetown University a few months ago, Bono said: “Commerce and entrepreneurial capitalism take more people out of poverty than aid.”⁹ The rock star’s wisdom encapsulates my analysis. There are enough problems in the ‘Utility Scenarios’ to allow for-profit firms to make a significant difference. As the private sector seems to be more effective at taking care of those problems, aid should be efficiently allocated to issues within the ‘Charity Scenario’. However, the context can change and the four scenarios will probably merge and mix in the future to meet the demand for different approaches.

⁸ Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens by Martin Gilens and Benjamin I. Page, http://scholar.princeton.edu/sites/default/files/mgilens/files/gilens_and_page_2014_-testing_theories_of_american_politics.doc.pdf

⁹ Bono’s Speech at Georgetown University in August 2013, www.ijreview.com/2014/01/108212-u2-rockstar-bono-admits-capitalism-cure-global-poverty.