

Reinventing Capitalism: a transformation agenda.●

Vision 2050 issue brief

Context

In 2010, the World Business Council for Sustainable Development (WBCSD) released Vision 2050, a landmark piece of work that laid out a pathway to a world in which nine billion people are able to live well, within planetary boundaries, by mid-century.

In 2019, WBCSD decided to revisit Vision 2050: 10 years on, there has not been as much progress made as required. WBCSD is working together with 40 member companies to reflect some of the great changes that have unfolded since 2010, to align the pathway with the Sustainable Development Goals (SDGs), and to prioritize the critical actions that business can take to unlock the transformations required to create a world where nine billion people can live well, within planetary boundaries.

The original Vision 2050's Economy pathway was clear that a radical shift in the way companies do business was required if the overall Vision was to be achieved. In 2050, the economy would be based on "true value" where profit and loss, progress, and value creation are redefined to consider longer term environmental impacts and personal and social well-being, and where prices reflect all externalities – costs as well as benefits.

Today, it is increasingly clear that unlocking the transformations required to address issues such as climate change, biodiversity loss and inequality will only happen if there is a shift in the outcomes that our market-based systems incentivize.

In other words, capitalism itself needs to be reoriented to serve a new purpose: not simply the pursuit of financial profits and economic efficiency, but the pursuit of true value, preserving and enhancing natural, social and financial capital. This is as much about long-term business success as it is about sustainability.

We have titled this issue brief "reinventing capitalism". It is deliberately provocative. In fact, as several of our members have pointed out, many of the shifts that we outline in this paper could take place within current corporate governance frameworks – within the agreed rules of the game of our current model of capitalism. But, at present, change is not happening at sufficient speed and scale, which is why we believe it is necessary to talk in terms of reinvention.

The COVID-19 pandemic has made the reinvention of capitalism even more important: it is now a critical part of the way in which we respond to, and recover from, the global pandemic. Not just in order to ensure that sustainable development is prioritized in recovery strategies, but because

the pandemic has shone a cold and harsh light on many of the negative outcomes generated by our current model. Companies cannot ignore the vulnerabilities that have been revealed.

The purpose of this issue brief is to lay out why capitalism can and should change – why the time is right for reinvention – and to explore some of the most important shifts that companies can drive, as well as the actions that other stakeholders, including governments and regulators, must take.

Issue brief at a glance

Capitalism is an economic system in which markets play a major role in guiding production and distributing income. Markets – and the outcomes they deliver – are shaped both by those participating in them, such as businesses and investors, and those overseeing them, such as governments and regulators.

The reason we are calling for capitalism to be reinvented is because the outcomes it is currently generating are unsustainable – socially, environmentally and economically. This is not simply a social and environmental agenda: it is about creating the conditions for long-term business success.

Capitalism's core features of private enterprise and competitive markets are indispensable if we are to achieve the scale and speed of transformation needed.

The capitalism we need is one that rewards true value creation – not value extraction as today's model does. All social and environmental costs and benefits should be internalized and reflected in the relative price of goods and services, and in companies' P&L statements, costs of capital and market valuations.

A reinvented capitalism focused on true value would lead to a world in which more companies innovate in ways that contribute to a flourishing society, capital markets properly value and reward inclusive, sustainable business practices and, as a result, more capital is mobilized to deliver the Sustainable Development Goals (SDGs) and the transition to a 1.5°C world.

To achieve these outcomes, we need a version of capitalism characterized by five features: stakeholder-oriented, impact-internalizing, long-term, regenerative and accountable.

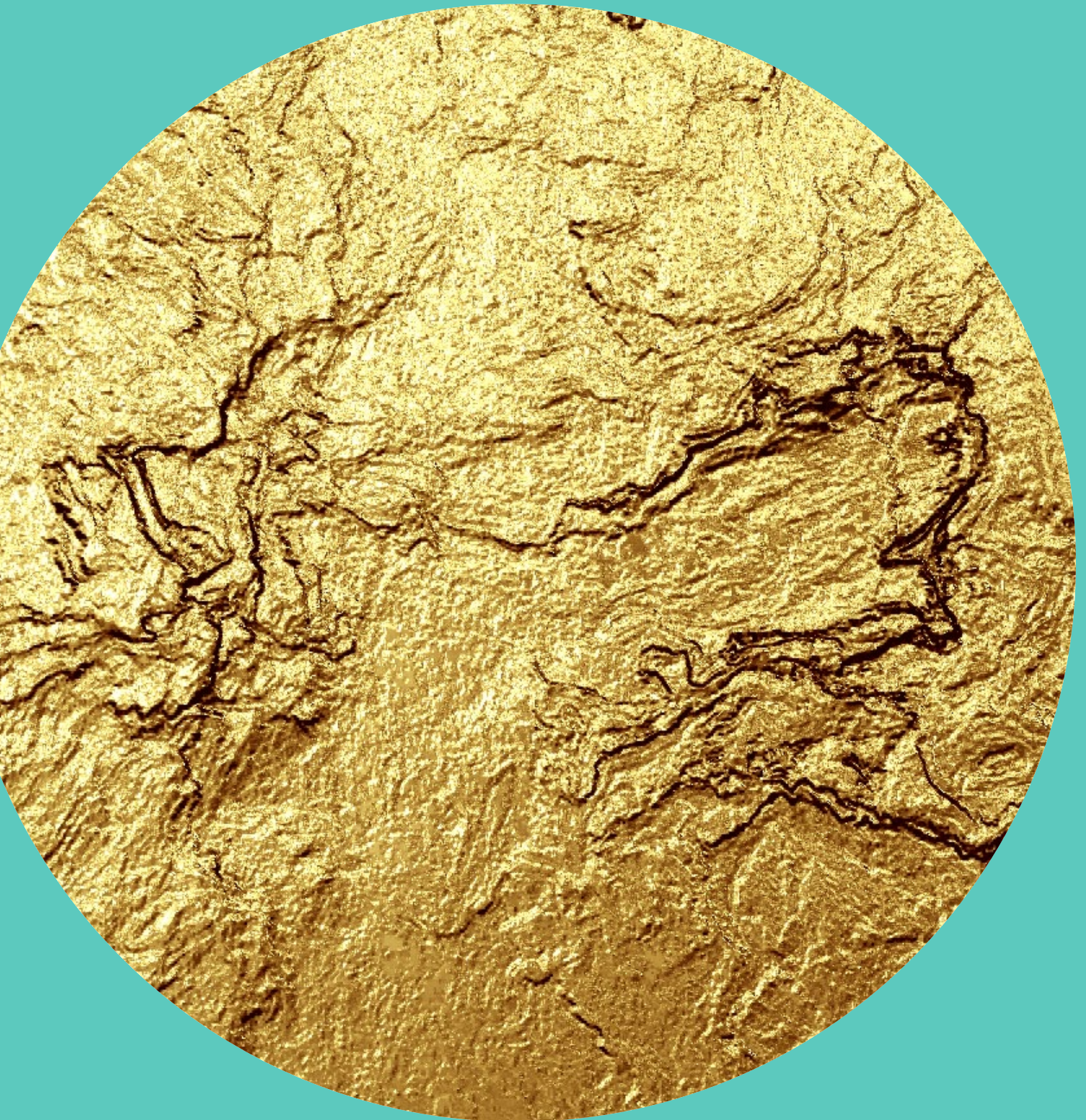
To get to such a version of capitalism, we need to realign the incentives that drive businesses' and investors' behavior by adopting new and better ways of measuring performance and tackling failures at the market and institutional level that favor financial value extraction over true value creation.

To play their part in shifting capitalism towards this vision, businesses must both “walk the talk” and advocate for changes to the “rules of the game”. To that end, we have proposed a set of priority actions that business can take – linked to a corresponding set of policy and regulatory changes that businesses can call for.

The debate about the future of capitalism is playing out in public, and COVID-19 has only increased interest in the conduct and convictions of companies. We believe that now is the time for companies and investors to enter – and lead – the debate not just about whether capitalism needs to change, but about how we go about reinventing it.

This issue brief synthesizes the best available thinking on that question and presents it in a way designed to be actionable for business today.

Introduction: Capitalism and Vision 2050



Introduction:

Capitalism and Vision 2050

Capitalism is the main operating system for today's global economy. The majority of production is guided and income distributed through the operation of markets on a for-profit basis. This is true across all major economies, albeit with significant differences between countries in terms of culture, regulation and the degree of state involvement.

Over centuries, the combination of for-profit enterprise and competitive markets that is the essence of capitalism has contributed to rising living standards, innovation and wealth creation.

However, it is clear that, today, our global economy is generating outcomes that are unsustainable – socially, environmentally and economically. Capitalism is both the greatest source of prosperity and progress in human history and the greatest threat to it. This paradox is at the heart of the case for reinvention.

The current system is generating unsustainably high levels of inequality and breaching planetary boundaries. Both science and history suggest that continuation on our current path will lead to catastrophe: ecological strain and economic stratification [have been shown](#) to play a central role in every past instance of civilizational collapse. But this does not mean we should abandon capitalism – quite the opposite. Harnessing the power of markets and for-profit enterprises is essential if we are to achieve the scale and speed of transformation needed to achieve our Vision of 9+ billion people living well, within planetary boundaries, by mid-century.

In this issue brief we make the case that capitalism can – and must – be reinvented so that it rewards true value creation, not value extraction. Specifically, our vision is for capitalism to reward value creation that internalizes all social and environmental costs and benefits. These costs and benefits should be reflected in the relative price of goods and services, and in companies' P&L statements, costs of capital and market valuations.

This builds on thinking that was originally laid out in the economic pathway of the first Vision 2050 report, issued a decade ago. In the intervening decade, progress has been made on assembling some of the building blocks for a capitalism that rewards true value creation. At the same time, the urgency and importance of reinventing capitalism has been heightened by the events of the last decade – from the long-term economic impact of the 2007-8 Financial Crisis, to headline-grabbing environmental catastrophes and widespread disaffection with the status quo.

This is not simply a social and environmental agenda: it is also about creating the conditions for long-term business success. A livable planet, cohesive societies, free and fair markets overseen by robust, inclusive institutions – these things are essential for any business

to thrive in the long run. If capitalism functions in a way that undermines the environmental and social systems that underpin economic prosperity, then in the long run we all lose. Ensuring markets do not reward behavior that undermines these systems is squarely in the private sector's best interest. Failure to do so will worsen a crisis of trust and an ideological backlash that is already evident in places.

Capitalism has been reinvented before – generally in response to periods of profound crisis, as happened following the Great Depression and World War Two, and again following the 'stagflation' era of the 1970s. It is likely that we are right now living through another period in which a series of rolling shocks to the system – resulting from rapid technological change, rampant inequality and the intensifying impacts of ecological overshoot – create conditions conducive to reinvention. Our challenge now is to move from talk to action – from tinkering to transformation – before our predicament gets worse.

No single sector can reinvent capitalism on its own, but reinvention will only be possible, in our view, if businesses and investors play a prominent role in driving the change. To do so, they will need to align both their actions and their advocacy with the vision of a capitalism that rewards true value creation. This issue brief outlines what businesses can do individually and where they need to collaborate with others.

① Taking stock



1.1 The case for reinvention

Globally, our economic system is producing a wide range of social and environmental outcomes – some good and some bad. Much of the societal progress that has been made in recent decades would be inconceivable without the creative dynamism of markets and business. But, on the flip side our current model of capitalism has contributed to levels of environmental and social damage that are unsustainable in every sense.

Headline positive and negative social and environmental outcomes c.1970-2020



In 1950, two-thirds of the world were living in extreme poverty; in 1980, it was still more than 40%; by 2015 the share of the world population in extreme poverty had fallen below 10%.

Today, roughly half the global population (3.6 billion people) qualifies as middle class – up from 1.8 billion people just a decade ago.

The global child mortality rate is less than 4% today – down from more than 18% in 1960.

Global average life expectancy increased by 5.5 years between 2000 and 2016.



As of 2015, at least four of nine planetary boundaries have been crossed as a result of human activity, according to researchers at the Stockholm Resilience Centre.

Since 1970, the populations of mammals, birds, fish, reptiles, and amphibians have, on average, declined by 60%.

Over the same period, the concentration of CO₂ in the atmosphere has gone from 325 parts per million (ppm) to more than 415ppm and rising.

Since 1980, income inequality has risen substantially across the majority of economies.

Our current version of capitalism incentivizes businesses to act, at times, in ways that directly contribute to negative societal outcomes. For example, financing for fossil fuels has continued to increase every year since the Paris Agreement, with 35 global banks providing a total of USD \$2.7 trillion (including almost USD \$1 trillion to companies 'aggressively planning new coal, oil, and gas extraction and related infrastructure') between 2016 and 2019.¹ This is not due to malign intent from the banking sector: it is a symptom of the fact that, throughout this period, it remained highly profitable for banks to engage in lending to projects that are not 'Paris-aligned.'

Similarly, incentives to invest in preserving natural and social capital, or in preparedness for future crises, are often weak at best. For example, though some parts of the global agriculture industry have started to embrace regenerative practices to slow – and ultimately reverse – the soil degradation and erosion that poses an existential threat to the industry's long-term future, these

practices are not yet widespread. Too often, short-term profits are incentivized over long-term resilience, leading some businesses to ignore lessons that have been well understood for millennia.

Lately, COVID-19 has also highlighted – and magnified – inequalities between those who derive a significant portion of their wealth and income from financial assets and those that do not. After an initial dip in March/April, financial markets have bounced back strongly during 2020, despite rising unemployment rates and significant damage to the real economy in most countries.

Resilient financial markets are a good thing, but this divergence is exacerbating social divisions because large swathes of society have little or no stake in the financial economy. In the US, for example, the richest 10% of households own almost 90% of all stocks and mutual funds.²

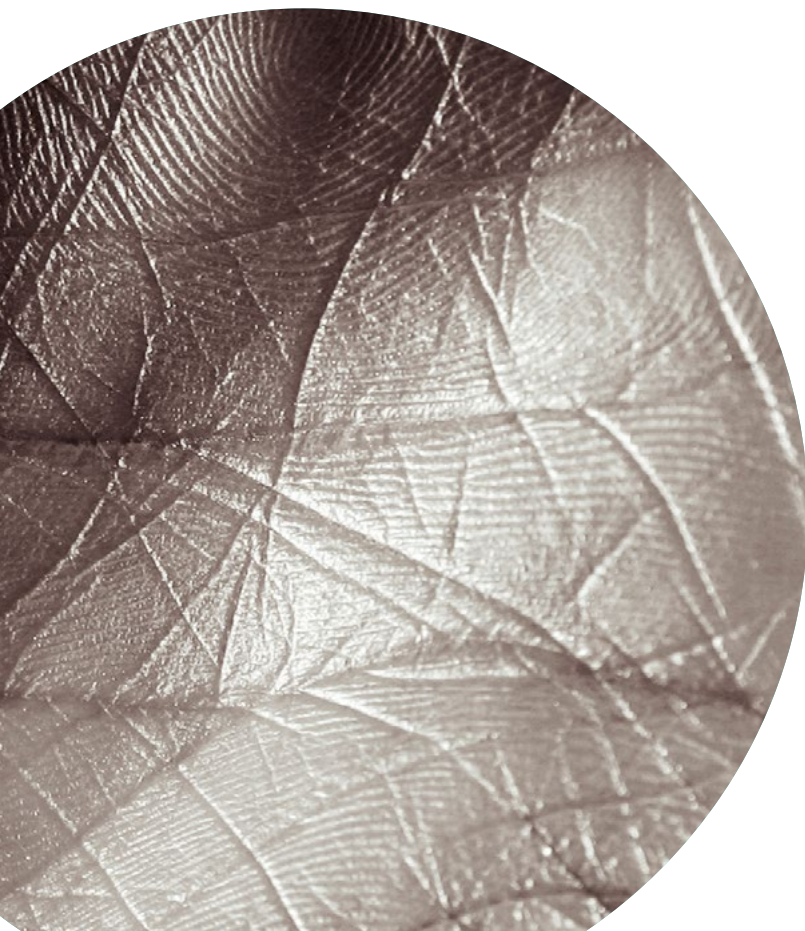
These are more than just market failures or policy failures: they are failures that arise out of the dynamic relationship between policy and markets – as we will explore in section 1.2..

A CRISIS OF TRUST

As the symptoms of social and environmental breakdown have become worse over the last decade, capitalism's popularity has started to wane. According to the 2020 Edelman Trust Barometer, [56% believe that 'capitalism as it exists today does more harm than good in the world'](#). Younger age cohorts are particularly likely to [express antipathy to capitalism](#) – a trend that could be further exacerbated by the long-term impact of the COVID-19 crisis on Gen Z's economic prospects.

This is leading many people – including an increasingly vocal group of avowed capitalists – to call for a fundamental 'reset'. Not simply because the status quo is unsustainable, but because the ideological backlash that the status quo is triggering threatens to make things worse. As Klaus Schwab of the World Economic Forum warned recently, without meaningful change to the way capitalism operates and the outcomes it generates, 'the ideological pendulum – already in motion – could swing back toward full-scale protectionism and other lose-lose economic strategies.'³

In this context, it is vital that business leaders, investors, regulators, governments and civil society actors work together to address the root causes of contemporary capitalism's negative outcomes.



1.2 Diagnosing today's capitalism: why is it delivering unsustainable outcomes?

Capitalism's core features – private enterprise and competitive markets – drive innovation that creates wealth and improves the range, quality and price of goods and services on offer. But, as we have seen, this is only half the story. For all its positive outcomes, capitalism today is failing in some profoundly important ways. Why?

The core problem is that today's capitalism does not distinguish between true value creation on the one hand, and value extraction on the other. This is in part because it privileges returns on financial capital over the preservation (let alone accumulation) of other forms of capital. As a result, the natural and social capital that underpins economic value creation is being rapidly depleted: by one estimate, the

[Earth's annual ecosystem services were depleted by USD \\$20 trillion between 1997 and 2011](#) – equivalent to more than two-thirds of global GDP growth over the same period.

Similarly, the resources of the public sector are undercut as a result of tax avoidance and profit shifting – to the tune of [USD \\$650 billion a year according to IMF economists](#). The socialization of risks and privatization of rewards looks increasingly like a feature of our system, rather than a bug.

In addition, following [decades of increasing market concentration in many industries](#), some firms are now so powerful relative to their competitors, suppliers, customers and regulators that, [in the words of economist Jeffrey Sachs](#), 'it's all

too easy [for some firms] to raise corporate valuations by harming others rather than by producing quality products at competitive prices.'

In short, profits are not, in today's capitalism, a reliable indicator of societal contribution because too many social and environmental costs and benefits are unaccounted for in financial valuations. This situation is a result of failures at multiple levels – from the way we think about and measure economic and business performance, to the market structures and dynamics that favor financial value extraction, to the institutions that are meant to oversee and regulate markets in order to ensure they function efficiently, fairly and sustainably.

Failures of today's dominant form of capitalism

CORE CHALLENGE

Capitalism today rewards value extraction, not just true value creation

Today's dominant form of capitalism privileges returns on financial capital over other forms. It rewards those who extract value as well as – or better than – those who create it. As a result, profits are an unreliable indicator of societal contribution because too many social and environmental costs and benefits are unaccounted for in financial valuations.

1. PERFORMANCE METRICS

Business: shareholder value maximization as the purpose of companies

The conduct of business and finance over the last 50 years has been heavily influenced by the view, famously articulated by Milton Friedman, that it is the duty of companies to maximize value for their shareholders. This view of the purpose of business has been at the core of most business education for decades, influencing the way generations of corporate executives think and act. It is embedded in the way that business performance is measured and managed. In practice, this creates an incentive – and rationale – for companies to engage in any (legal) activity, so long as it enables them to generate additional returns for shareholders, even if this is to the detriment of other stakeholders.

Economics: value equals price

Economics is capitalism's master discipline: the way that economists think about value has profound consequences for policy and markets. Remarkably, for most of the last century, mainstream economists have thought very little about the nature of value. Instead, economics has relied on the assumption that the value of any good or service is simply equivalent to the price that good or service can be sold for in an open market. Since many social and environmental costs and benefits are not priced by markets, these are excluded from the primary definition of value that has shaped accounting practices, policymaking and business thinking. As we now know, this is a dangerous omission.

Policy: GDP growth as the overriding priority

Policymaking in recent decades has largely been built around the premise that GDP growth is the primary goal of the economic system. This is problematic for at least two reasons. First, because GDP growth does not necessarily correlate with social progress or societal wellbeing – particularly in countries that already have a relatively high GDP per capita. Recent decades have shown that wealth does not automatically “trickle down” and that GDP growth alone does not necessarily make societies healthier, happier and more inclusive. Secondly, GDP does not include environmental and social costs arising from pollution, damage to ecosystems or consumption of non-renewable resources. We now know that these costs are significant and that they accumulate over time in ways that an overriding focus on GDP growth has led policymakers to ignore.

2. MARKET STRUCTURES AND DYNAMICS

Increased financialization and short-termism

Well-functioning financial markets are essential: the ability to raise capital (debt or equity) is what fuels the innovation that has helped to improve billions of lives and livelihoods in recent decades. But, today, the global financial industry has become so large, so powerful and so complex that some of the activities it engages in no longer contribute to shared prosperity, but actually undermine it. Beyond a certain point, ‘financialization’ fuels inequality and undermines stability, while channeling financial resources into speculation rather than real economy investment and lending. And since contemporary financial markets are rife with asymmetries in terms of different actors’ level of exposure to risk and reward, financialization is a driving force behind the prioritization of short-term profits over long-term resilience.

Liquidation of non-renewable stocks of natural and social capital

Since many of the ‘ecosystem services’ businesses rely on to create value are unpriced (or inadequately priced), it is all too possible for firms to enhance profits by liquidating nonrenewable stocks of natural and social capital. Worse, in the absence of effective pricing, the goal of maximizing economic growth and financial returns creates a powerful incentive for countries and companies to ignore or externalize the costs of social and environmental damage. Advances in accounting for non-financial risks and impacts have the potential to change this, but only if better information is accompanied by a realignment of incentives for all market participants: from asset owners and asset managers to corporate managers.

Increased market concentration

Genuine competition is what drives the continuous innovation and improvement that underpins capitalism’s ability to deliver rising living standards, but, in recent decades, many markets have become less – rather than more – competitive. For example, [in the US, between 1997 and 2012, the four largest firms in every sector increased their share of their sector’s revenues from 26% to 32%](#). This is to be expected in markets where firms seek to maximize profits and regulators take a relaxed approach to policing market concentration, but it has important negative consequences: insufficient competition may mean that a small number of firms become so dominant that they are able to extract excess profits at the expense of other stakeholders and would-be competitors.

3. INSTITUTIONS

Lack of global coordination on setting and enforcing “rules of the game”

Markets require ‘[adult supervision](#).’ Currently, there is often a mismatch between the relative weakness of regulators and the relative power of the businesses they are meant to regulate. In a globalized economy, sovereign states’ ability to set their own “rules of the game” is limited by multinational companies’ ability to operate across borders and shift profits to other jurisdictions with more favorable tax and regulatory regimes. This is particularly problematic at a time when multilateralism and the norms supporting international cooperation are weak. When countries compete rather than coordinate on setting rules, this creates complexity for businesses and puts a downward pressure on tax rates and environmental standards.

Lack of standardized and mandatory ESG accounting rules

For markets to price in environmental, social and governance (ESG) risks and impacts, investors, regulators and other market actors require high quality, comprehensive, comparable data on those risks and impacts. Currently the data available is patchy, backward-looking and difficult to compare across companies and sectors. Despite growing uptake of various ESG metrics and frameworks, efforts at standardization and harmonization are still emergent – and, in most cases, non-financial reporting remains voluntary rather than mandatory.

Under-investment in public goods

The ability of businesses and markets to create value is underpinned by public goods such as healthy, educated workers and consumers, physical and digital infrastructure, basic research and the rule of law. When the institutions that provide these public goods are under-funded, as is often the case today, it becomes harder for either business or society to thrive. The failure to invest sufficiently in public goods is in part a policy failure, but it is also a function of a version of capitalism that drives the socialization of risks and privatization of rewards, thereby starving the public sector of resources.

To create a version of capitalism that rewards true value creation, but not value extraction, we will need to tackle failures at all three levels. New metrics will only lead to real accountability if they are backed up by changes to market structures and institutions that ensure businesses, investors and policy makers have a clear incentive to incorporate this new information into their decision making.

1.3 Existing efforts to address capitalism's weaknesses: a status report

1. THE INFORMATION REVOLUTION: ACCOUNTING FOR ESG RISKS AND IMPACTS

Many elements of the diagnosis set out above are not new – and nor are efforts to address the weaknesses highlighted. Here, we briefly review efforts to date in two key areas:

1. Changing how we measure and account for corporate performance

2. Shifting the incentives that drive companies' and investors' behavior

In both areas, considerable progress has been made since the original Vision 2050 was published a decade ago. Consciously or not, we have been laying the foundations for a reinvention of capitalism for some time.

Since 2010, dozens of new accounting and reporting frameworks for ESG risks and impacts have emerged – notably the [Sustainability Accounting Standards Board](#) (SASB) (established in 2011; industry-specific sustainability accounting standards published in 2018) and the [Task Force on Climate-Related Financial Disclosures](#) (TCFD) (established in 2015; recommendations published in 2017). Meanwhile, uptake of previously existing frameworks – such as the [Global Reporting Initiative's \(GRI\) standards for sustainability reporting](#) and [CDP's disclosure platform for greenhouse gas emissions and other environmental impacts](#) – has also increased substantially.

As the field of sustainability accounting matures, it is now moving from proliferation towards consolidation. Efforts to achieve convergence around common standards and metrics are already in motion: notably, in September 2020, the World Economic Forum's International Business Council (IBC), in collaboration with Deloitte, EY, KPMG and PwC, published a list of ESG metrics and disclosures that all companies should adopt.⁴ Further iteration is likely, but a standardized approach to non-financial reporting is now in sight.

The next step will be to drive these standards into mainstream accounting rules and make disclosure mandatory. In September 2020, New Zealand became the first country to formally announce that it would be making TCFD disclosures mandatory.⁵ The EU is due to launch its Taxonomy for Sustainable Activities (focused initially on climate, but with other areas of environmental impact to follow) by the end of the year.⁶ Meanwhile, the Global Investors for Sustainable Development (GISD) Alliance has called for the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to integrate ESG disclosures into their respective accounting standards in an internationally consistent manner.⁷ The International Organization of Securities Commissions (IOSCO) has announced plans to launch a task force on sustainable finance.⁸ And, in September 2020, the International Financial Reporting Standards Foundation (IFRS) launched a consultation to assess demand for global sustainability standards and the role it might play in developing those standards.⁹

Clearly there is much work still to be done, but robust, comprehensive, mandatory non-financial accounting standards no longer seem like an impossibility: they seem inevitable.

2. REALIGNING INCENTIVES: GOVERNANCE, LAW AND REGULATION

The 2010s also saw the emergence of innovative legal forms designed to enable companies to formally commit to purposes other than profit maximization. Examples include the ‘benefit corporation’ (primarily in the US) and, more recently, the ‘Entreprise à Mission’ in France, where Danone became the first company to adopt this new legal status in June 2020.¹⁰ Meanwhile, more than 3,000 companies worldwide have certified as B Corporations.¹¹

As a next step, some have advocated amending corporate law to make the benefit corporation model mandatory rather than voluntary.¹² However, there are doubts about how much real change this would lead to, as well as concerns that such a shift could unintentionally reduce the level of accountability for Boards and management teams.¹³

An alternative path to reinvention is through a reinterpretation (or, where necessary, revision) of the fiduciary duties of company directors and asset managers. Thanks to the work of the ‘Fiduciary Duty in the 21st Century’ project and others, it is now well established in many jurisdictions that fiduciaries do have an obligation to consider material ESG issues in investment decisions. This is undoubtedly progress, but the current definition of materiality means that fiduciaries

(as per the project’s 2019 status report) are not required ‘to account for the sustainability impact of their investment activity beyond financial performance... fiduciary duties require consideration of how sustainability issues affect the investment decision, but not how the investment decision affects sustainability.’¹⁴ The project now seeks to clarify that investors also have a duty to ‘understand and incorporate into their decision making the sustainability preferences of beneficiaries clients, regardless of whether these preferences are financially material.’¹⁵

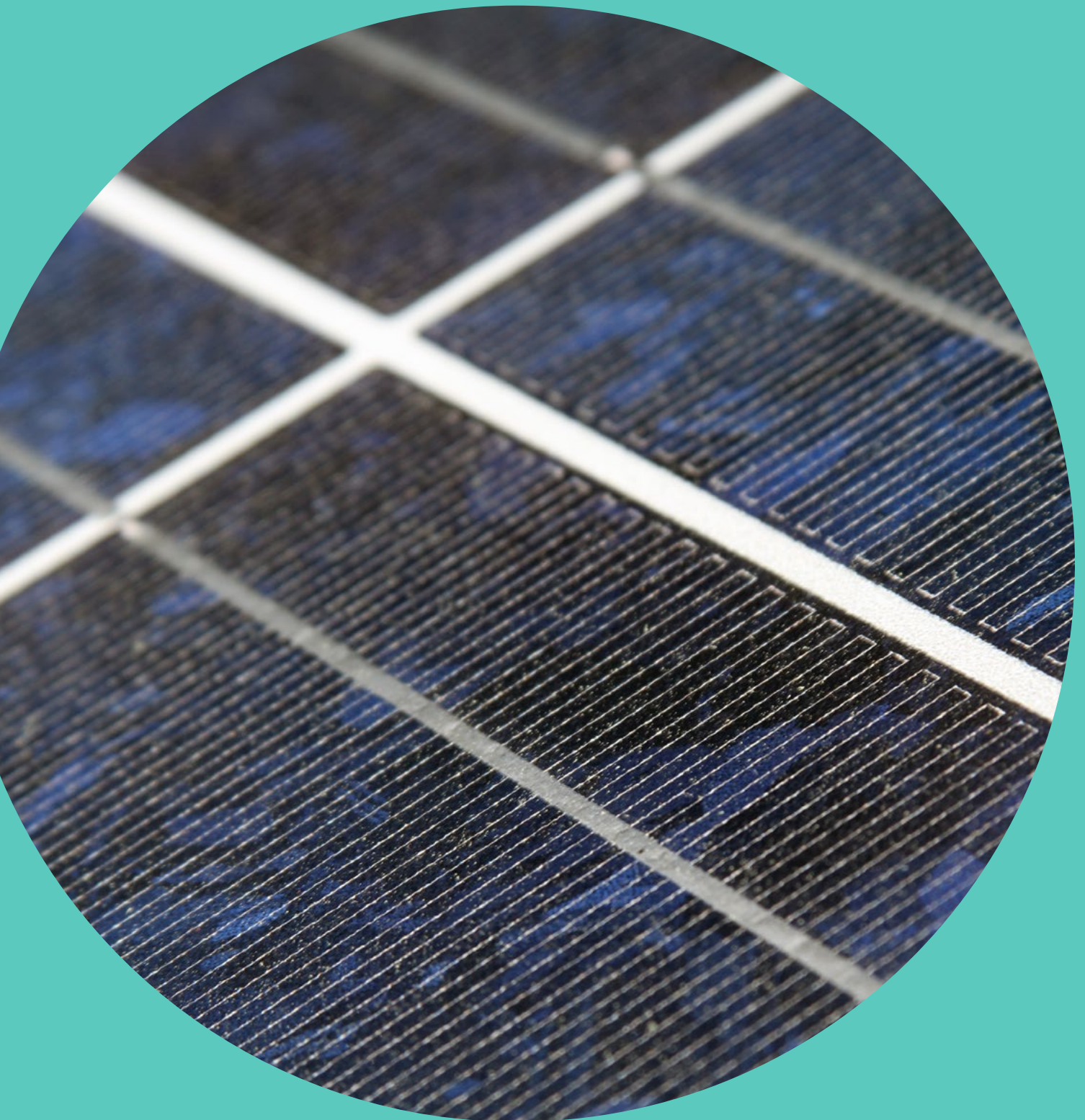
Governments have also made some progress on implementing policies designed to correct existing market failures, distortions and asymmetries in the last decade. For example, the proportion of global GHG emissions subject to some form of carbon price has tripled since 2010¹⁶ – from 5% to 15% (though still only 1% at or above a level consistent with what leading economists have said is required to meet the ambition of the Paris Agreement).¹⁷ Meanwhile, antitrust enforcement is higher on the political agenda in many countries than it has been in decades – as is tax avoidance. The OECD/G20-led effort to ‘put an end to tax avoidance strategies that exploit gaps and mismatches in tax rules’¹⁸, which 137 countries are involved in, aims to reach an agreement in mid-2021.

These existing efforts to reform accounting, governance, law and regulation have not yet led to a fundamental reinvention of capitalism, but we are not starting from scratch: at least some of the building blocks of a reinvention agenda are already in place.

In Part 3, we will cover a more comprehensive set of ideas for action, but first we must consider where we are trying to get to: what kind of capitalism do we need in order to achieve the SDGs, the Paris Agreement and Vision 2050?



② The capitalism we need



The capitalism we need

Capitalism as currently practiced is generating both positive and negative outcomes. The goal of reinventing capitalism is to ensure that the power of private enterprise and competitive markets is better directed towards enabling 9+ billion people to live within planetary boundaries. This is not simply about tinkering around the edges of contemporary capitalism: it involves a fundamental shift in the purpose of business and the global economy as a whole – from the pursuit of financial profits and economic efficiency for their own sake, to the pursuit of true value.

A reinvented capitalism focused on true value would lead to three outcomes that are critical for achieving the speed and scale of transformation required to deliver Vision 2050:

1

More well-run companies, making better decisions, that deliver the necessary product, service and business model innovations that contribute to a flourishing society.

2

Capital markets properly value inclusive, sustainable business practices, rewarding the companies with the greatest positive social and environmental impact.

3

As a result, more capital is mobilized towards businesses, assets and solutions that deliver the Sustainable Development Goals (SDGs), including the transition to a 1.5°C world.



2.1 Features of a reinvented capitalism

In recent years, as it has become increasingly apparent that capitalism-as-usual is failing in some important ways, initiatives championing new forms of capitalism have flourished: [Conscious Capitalism](#), [Inclusive Capitalism](#), [Long-term Capitalism](#), [Moral Capitalism](#), [Multicapitalism](#), [Stakeholder Capitalism](#) and [Regenerative Capitalism](#) – to list just some of the most prominent labels currently in circulation.

There are some important differences between the ideas that sit behind each of these different labels, but there are also many recurring and overlapping themes. Among these, we spotlight five key features of the capitalism we need:

Stakeholder-oriented,
rather than shareholder-
value-maximizing

Impact-internalizing,
rather than impact-
externalizing

Long term,
rather than
short term

Regenerative,
rather than
degenerative

Accountable,
rather than
unaccountable

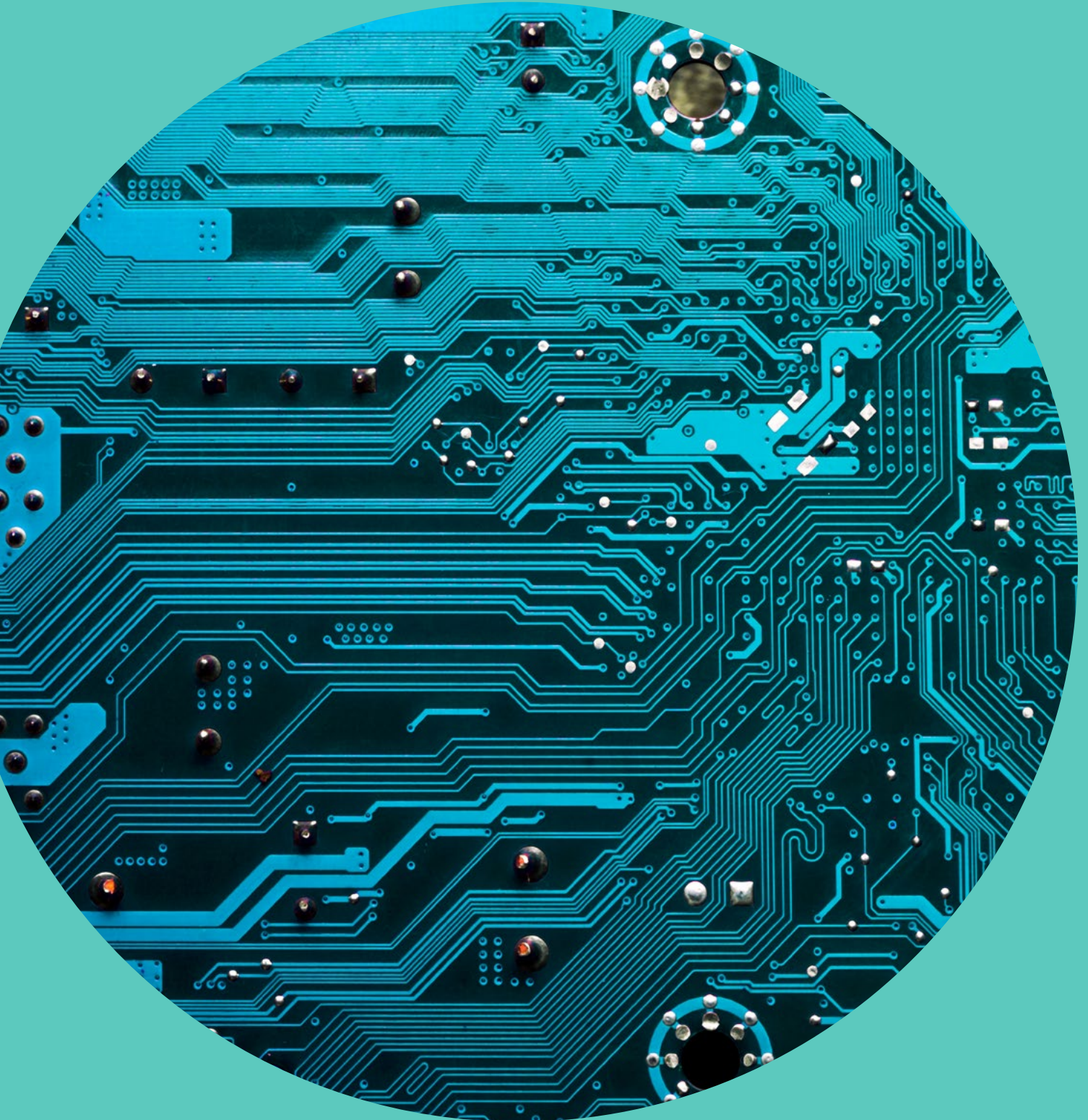


Below we summarize the essence of each of these five features and list the key organizations and individuals promoting each feature. These features are complementary to one another, rather than mutually exclusive. Ultimately, all five are critical if we are to achieve the vision of a capitalism that rewards true value creation – not value extraction.

Five Features of the capitalism we need

FEATURE	ESSENCE	KEY PROPONENTS
Stakeholder-oriented	The purpose of business is to create value for all stakeholders: employees, customers, suppliers, communities, the natural environment and shareholders. These multiple obligations can and should be harmonized and incorporated into corporate decision making, governance models and incentive systems.	Business Roundtable; ¹⁹ Imperative 21; ²⁰ World Economic Forum ²¹
Impact-internalizing	Positive and negative social and environmental impacts should be internalized into the relative price of goods and services and market valuations of companies. Businesses and investors should seek to optimize performance across three dimensions: risk, return and impact. Governments should step in to price externalities where markets are not able to internalize them of their own accord.	George Serafeim, Harvard Business School ²² ; Sir Ronald Cohen ²³
Long-term	The goal of reform should be to stretch businesses' and investors' time horizons to better align these with the much longer timeframes over which social and environmental feedback loops play out. This would lead to better pricing and management of long-term risks such as climate change, ultimately averting 'the tragedy of the horizon.' ²⁴	Climate-KIC; ²⁵ Dominic Barton; ²⁶ Embankment Project for Inclusive Capitalism; ²⁷ Focusing Capital on the Long Term ²⁸
Regenerative	Regenerative Capitalism is based on the premise that there are universal principles and patterns of systemic health – such as circularity and balance – that can and should be integrated into economic system design. Companies should seek to actively contribute to the health of economies, societies and the environment. Both business and policy action should be guided by the need to preserve and enhance multiple forms of capital, including social and natural capital.	John Fullerton, Capital Institute ²⁹
Accountable	Both capital markets and regulators must provide active oversight and control of companies, holding them accountable for their actions and impact. Investors should prioritize stewardship not just profit maximization – and fiduciary duties should evolve to reflect this dual purpose. It is also essential for markets to be regulated and counterbalanced by governmental and non-governmental institutions that are strong enough to be effective and inclusive enough to represent the interests of society as a whole.	Federated Hermes; ³⁰ Rebecca Henderson, Harvard Business School; ³¹ The Democracy Collaborative; ³² The Shareholder Commons ³³

③ Getting from here to there: the reinvention agenda



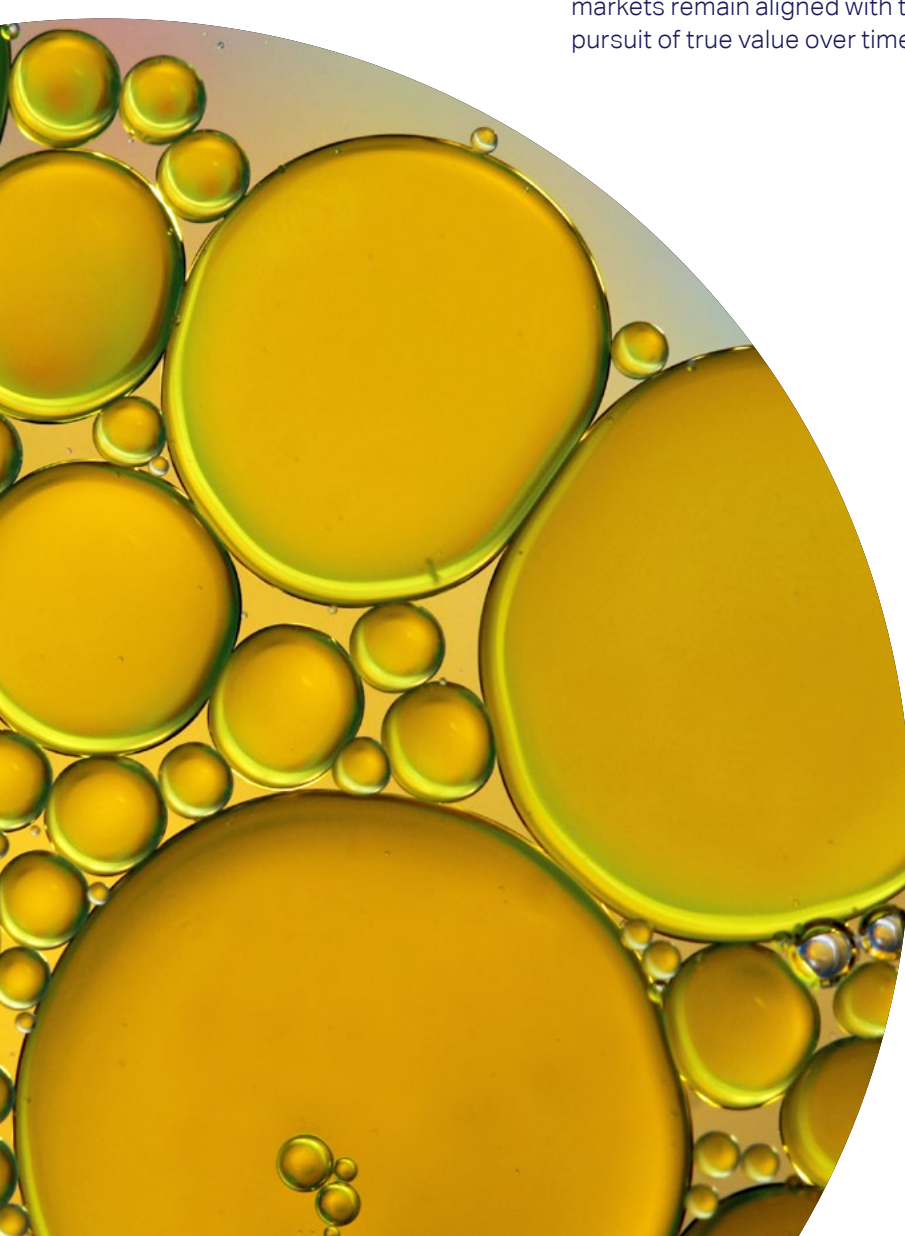
In the previous section we highlighted five features of the capitalism we are aiming for. Different organizations and individuals will emphasize one feature more than others, but there is little substantive disagreement over the vision for capitalism, which we have summarized as follows: **The capitalism we need is one that rewards true value creation – not value extraction.**

The vital question is how we get there. To answer this, we must return to the failures of contemporary capitalism that we identified in part 1 – specifically the three main types of failure we outlined:

- 1. Performance metrics** that are either very incomplete or that fail to distinguish between true value creation and financial value extraction.
- 2. Market structures and dynamics** that favor short-term financial value extraction over long-term true value creation.
- 3. Weak, fragmented institutions** that are incapable of adequately addressing market failures, providing necessary public goods, or setting and enforcing rules that ensure markets remain aligned with the pursuit of true value over time.

To reinvent capitalism, it is vital that we address all three levels of failure. There are no silver bullets for doing so: a piecemeal approach to reinvention is unlikely to work and the task is too great for either the private or the public sector to achieve on its own. Pragmatism therefore demands that businesses, investors and governments (including regulators) work together to address these failures. Businesses and investors can take many practical steps on a voluntary basis, but policymakers and regulators will also need to act to ensure that the “rules of the game” support those willing and able to do the right thing.

Voluntary action from the private sector on the one hand, and changes to law and regulation on the other, should not be seen as binary alternatives: they are necessary complements to one another. More than that, we must actively look for synergies and reinforcing feedback loops between the steps taken by businesses, investors and policymakers to realign our model of capitalism.



Below we summarize a wide range of ideas for reinventing capitalism – all of which have been proposed or piloted by respected institutions working on this agenda. The ideas are organized according to which feature they most closely relate to (though many relate to more than one) and which set of actors – companies, investors or policymakers and regulators – is best placed to drive action. For more detail on the specific proposed actions and where they come from, see Appendix.

The reinvention agenda at a glance

FEATURE	BUSINESS	CAPITAL MARKETS	POLICY & REGULATION
Stakeholder-oriented	<p>Articulate a statement of purpose, signed off by the Board of Directors, that clarifies how the company intends to create value for all stakeholders</p> <p>Incorporate multi-stakeholder considerations into governance models, decision making and incentives</p> <p>Rigorously account for and report on ESG risks and positive/negative stakeholder impacts</p> <p>Link executive remuneration to stakeholder impact metrics</p>	<p>Integrate non-financial risks and outcomes into investment strategies</p> <p>Ensure asset managers' remuneration reflects stakeholder impact, not just short-term financial gains</p>	<p>Incorporate responsibility for managing stakeholder/societal impact into the fiduciary duties of investors and company directors</p> <p>Make disclosure of ESG risks and impacts mandatory and standardized</p> <p>Enforce antitrust rules to ensure free and fair competition</p> <p>Enact and enforce robust laws and regulations to protect all categories of stakeholders: workers, consumers, communities and the environment</p>
Impact-internalizing	<p>Put a price on externalities when assessing capital expenditures and R&D investments</p>	<p>Align investment strategies with clients'/beneficiaries' non-financial preferences, as well as their financial interests</p> <p>Update valuation tools to incorporate non-financial forms of capital into decision making</p>	<p>Update legal frameworks to make influence on corporate strategy contingent on having "skin in the game"</p> <p>Ensure market prices reflect the full social cost and/or benefit of externalities</p>
Long-term	<p>End quarterly earnings guidance and instead actively engage with shareholders around long-term strategy, including the need to preserve and enhance non-financial forms of capital</p> <p>Ensure all dividend payments and share buybacks are consistent with long-term strategy and value creation</p> <p>Reduce the share of executive pay that is tethered to stock price</p>	<p>Update valuation tools so that they do not systematically discount the interests of future generations</p> <p>Asset managers and investment consultants should be remunerated and incentivized on the basis of long-term financial and non-financial performance</p>	<p>Use fiscal policy to create incentives for investors to hold onto shares for longer periods</p> <p>Increase influence of long-term "anchor" shareholders in corporate governance</p>
Regenerative	<p>Develop products, services and business models that actively contribute to the health of economies, societies and the environment</p>	<p>Channel capital towards new business formation and critical infrastructure projects that deliver social and/or environmental benefits</p>	<p>Shift the burden of taxation from "goods" (eg., employment) to "bads" (eg., pollution)</p> <p>Disincentivize financial speculation and incentivize investment in real economy projects, especially those with clear social and/or environmental benefits</p> <p>Reduce or remove incentives for companies to prefer debt to equity capital</p>
Accountable	<p>Contribute to the health of non-market institutions that are needed to provide public goods and keep market failures in check by paying taxes in a fair and transparent way</p>	<p>Adopt responsible stewardship practices and engage with corporate management on ESG issues</p> <p>Encourage asset owners and end beneficiaries to state clear preferences with regard to non-financial outcomes and embed these preferences in investors' mandates</p>	<p>Overhaul the international tax system to make tax avoidance harder</p> <p>Strengthen multilateral institutions designed to address systemic risks and to coordinate policy responses to market failures</p>

④ Where to start: priorities for business



A piecemeal approach to reinventing capitalism is unlikely to succeed:

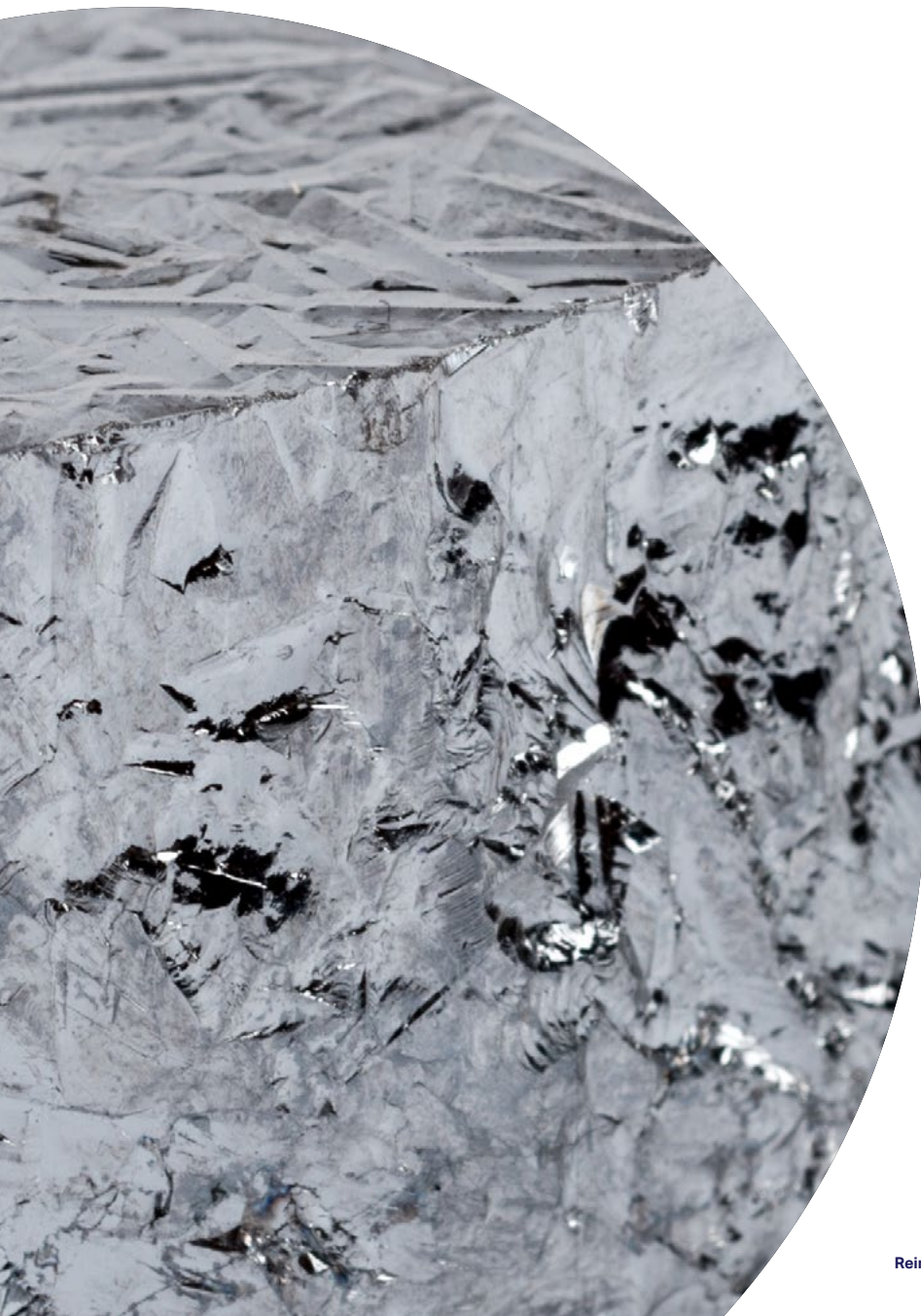
there are deep interdependencies between the many different ideas for action outlined above. We need bold leadership across all sectors and a joined-up approach that activates positive feedback loops between private sector strategies for creating true value and public sector actions to ensure the “rules of the game” favor true value creation.

The complexity of the task ahead cannot, however, become an excuse for inaction. Now is the time for companies and investors to step up in two ways:

1. To “walk the talk” by adapting and aligning business models, decision making processes, governance models, incentives, approaches to tax, remuneration, reporting and accounting with a vision of capitalism that pursues true value.

2. To leverage their relationships with other stakeholders – from suppliers and customers to policymakers and civil society – to influence the norms and rules that shape capitalism as a whole.

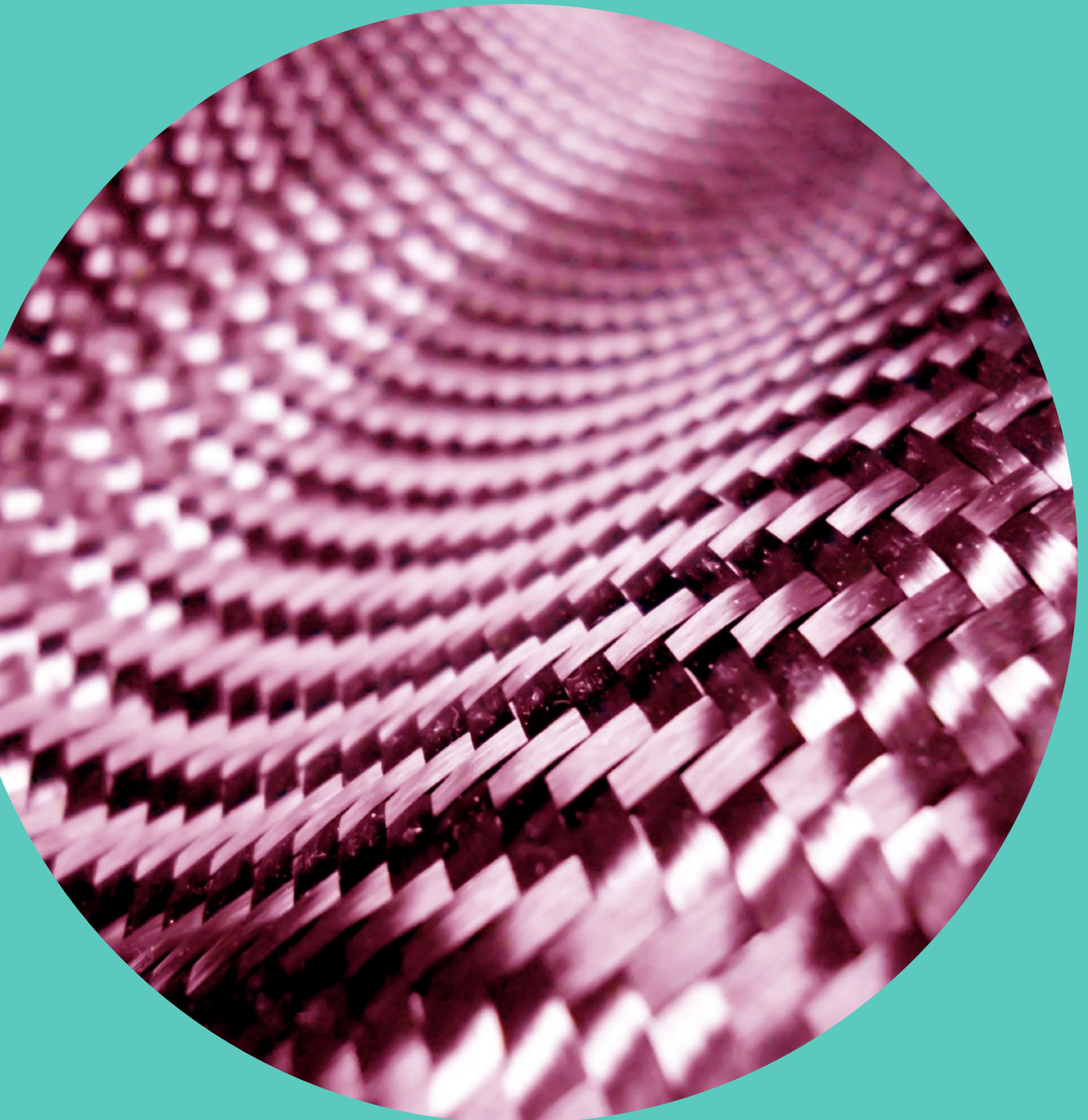
To be effective, it is essential that businesses collaborate and cooperate: influence requires unity of purpose, consistency of messaging and critical mass of support for key asks of policymakers and regulators. This is why – following consultation with WBCSD member companies – we distilled the ideas for action laid out in the previous section into a shortlist of three actions that businesses and investors can take – accompanied in each case by a corresponding action required of policymakers and regulators, which private sector actors can advocate. These are not the only ideas and actions that business should consider. But we are confident that prioritizing these will lead to progress in the right direction and the opportunity for further debate and refinement.



Priority action areas for business and other stakeholders

	CHANGES THAT BUSINESS CAN IMPLEMENT	CHANGES THAT BUSINESS CAN ADVOCATE	EXPECTED CONSEQUENCES
PERFORMANCE METRICS	<p>Rigorously account for and report on ESG risks and impacts</p> <p>Businesses should apply the same level of rigor to the measurement of ESG risks and impacts as they do to measuring financial performance. As a starting point, all businesses should look to align their disclosures with the recommendations set out in the World Economic Forum's September 2020 White Paper on 'Measuring Stakeholder Capitalism'.³⁴</p>	<p>Make disclosure of ESG risks and impacts mandatory and standardized</p> <p>International standard setting bodies, including IASB, FASB, IOSCO and IFRS should prioritize creating harmonized standards for non-financial accounting. Governments and regulators should lay out a pathway and timeline for these standards to become integrated into mainstream accounting rules in an internationally consistent manner.</p>	<ul style="list-style-type: none"> • Capital markets better able to evaluate risks and impacts and integrate these into their analysis • A realignment of financial flows away from firms that are highly exposed to ESG risks and towards those with a lower risk profile – creating a race to the top among companies • Greater accountability for risk and impact management in corporate governance
MARKET STRUCTURES AND DYNAMICS	<p>Incorporate multi-stakeholder considerations into governance models, decision making and incentives</p> <p>All businesses, regardless of legal status or ownership model, should seek to establish robust mechanisms for ensuring the interests of all stakeholders are incorporated into decisions about strategy and investment. A portion of executive remuneration should be linked to stakeholder impact metrics. Assessment models used to allocate capital expenditures and R&D investments should incorporate social and environmental costs and benefits.</p>	<p>Revise fiduciary duties of company directors and investors to incorporate ESG risks and impacts</p> <p>Governments, regulators and investors around the world should align policy and practice with the principles set out by the 'Fiduciary Duty in the 21st Century' project. Specifically, all parties should aim for clarity and consistency about the fact that fiduciaries have an obligation not only to incorporate financially material ESG factors into their investment decision making, but also to understand and incorporate the sustainability preferences of their beneficiaries/clients, regardless of whether these preferences are financially material in the traditional sense.</p>	<ul style="list-style-type: none"> • Stronger incentives for companies and investors to focus on true value, not value extraction • Stronger governance of – and accountability for – strategies to reduce harm and increase positive impact • Capital allocated (both within and across firms) in a way that better reflects stakeholder impact and true value, leading to investments that enhance social and natural capital, as well as financial capital • More engaged and productive workforces
INSTITUTIONS	<p>Pay taxes in a fair and transparent way</p> <p>The health of capitalism is inseparable from the health of the institutions that exist to provide public goods and ensure that markets are free and fair. Paying taxes is one of the main ways in which companies contribute to society and it is incumbent on all companies to pay their fair share. Tax avoidance undermines both the effectiveness and legitimacy of governments, which in turn destabilizes markets. Companies should ensure their tax practices align with the intent behind tax laws, irrespective of legalities. All companies should establish clear ethical guidelines to govern their approach to paying taxes and be transparent about what tax they pay and where.</p>	<p>Shift the burden of taxation from "goods" to "bads" and ensure a level playing field globally</p> <p>Governments should seek to shift the burden of taxation from "goods" (such as employment) to "bads" (such as pollution). They should use both fiscal policy and regulation to ensure social and environmental costs and benefits are properly priced. Reforms to the international tax system to make tax avoidance harder should also be a priority. Specifically, governments should commit to implementing the recommendations of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) to eliminate gaps and mismatches in tax rules.</p>	<ul style="list-style-type: none"> • Increased capacity for governments to invest in public goods necessary for business to thrive • A reduction in extremes of inequality • Enhanced perception(s) of fairness, restoring trust in business and politics • Positive and negative externalities incorporated into prices and valuations, leading to capital allocations that are better aligned with the goal of creating true value

Conclusion



Conclusion

Capitalism's dynamism is its greatest strength. Competition between private enterprises operating on a for-profit basis can be a powerful force for good – driving innovation and an efficient allocation of resources – but only if the rules and norms that give direction to markets privilege true value over value extraction.

Currently, as we have seen, this is not the case, which is why a reinvention of capitalism – to reorient it towards the goal of preserving and enhancing natural, social and financial capital – is necessary. Profit can be a powerful motivating force and the need to turn a financial profit imposes a healthy level of discipline on private enterprises. But markets that pursue financial profits while disregarding other outcomes are doomed to undermine the sources of their own profitability.

Make no mistake, reinventing capitalism along the lines suggested in this issue brief will be very challenging. It will require complementary action from many different actors across all sectors and continents. It will require leaders from business, government and finance to embrace a broader – and longer – definition of self-interest than is the norm today, recognizing that a livable planet, an equitable society, and genuinely free and fair markets are in their individual and collective self-interest. And, critically, it will require a huge amount of trust: only if businesses and governments trust one another will they have the confidence to take the steps needed to reinvent capitalism.

This is why the priorities for action outlined in part 4 of this brief emphasize both what businesses can do to “walk the talk” and the corresponding actions required of other stakeholders – particularly policymakers and regulators. The alignment of action and advocacy is necessary to demonstrate trustworthiness and to increase the likelihood of effectiveness. Those who pursue action without advocacy are more likely to experience a first mover disadvantage; those who pursue advocacy without action will be dismissed as disingenuous.

Capitalism has been transformed before and it will be again. Indeed, it is likely that, with the status quo rocked by the COVID-19 crisis and its aftermath, we are living in a moment conducive to the reinvention of capitalism – the kind of moment that only comes along every 40-50 years. Our success or failure in achieving our Vision 2050 is likely to hinge to a significant degree on whether capitalism can be reinvented for the better during the next ten years. The time for businesses to step up – in both word and deed – is now.

Appendix

Appendix

This appendix contains detailed explanations for each of the ideas for reinvention included on page 19. Every idea listed has already been proposed elsewhere by one or more respected institutions working on this agenda. What we have done is simply to take stock of the best ideas on reinventing capitalism currently in circulation and gather them together in one place.

KEY

- Business
- Capital Markets
- Policy & Regulation

ACTION	EXPLANATION
STAKEHOLDER-ORIENTED	
<p>1 Articulate a statement of purpose, signed off by the Board of Directors, that clarifies how the company intends to create value for all stakeholders</p>	<p>Following on from the Business Roundtable's 2019 'Statement on the Purpose of a Corporation'³⁵ and the World Economic Forum's 2020 Davos Manifesto³⁶ – both of which emphasize that the purpose of a corporation is to serve multiple stakeholders – academics and investors have called on all companies to issue their own statement of purpose.</p> <p>Robert Eccles, a Visiting Professor at Said Business School and one of the chief advocates of this idea, sums it up as follows: 'The board of a company should publish an annual one-to-two page "Statement of Purpose" that clearly articulates the company's purpose to profitably achieve a solution for society. It specifies within that purpose the few stakeholders most critical to long-term value creation and sustainability... The board of directors is the body with the ultimate authority for representing the interests of the corporation. It is responsible for taking a long-term intergenerational perspective that transcends CEO tenures and business cycles. Thus, it is the board's responsibility to articulate the purpose of the corporation.'³⁷ Such a statement of purpose should, in principle, lead to greater accountability for stakeholder impact at Board level.</p>
<p>2 Incorporate multistakeholder considerations into governance models, decision making and incentives</p>	<p>There is no one-size-fits-all approach to incorporating multi-stakeholder considerations into governance and decision making, but many potential models exist. Over the last decade, thousands of businesses — primarily in the US — have become 'benefit corporations', meaning they incorporate a commitment to creating positive impact for society, workers, the community and the environment into their charters. In Germany, public companies have long been required to have a supervisory board made up of both worker and shareholder representatives. In India, companies are required to spend 2% of profits before tax on community initiatives, and to create a board committee to oversee this.</p> <p>Others advocate profit sharing or even employee ownership, both of which are rare today amongst large firms though they are by no means new ideas. Some critics of shareholder capitalism see employee-owned B Corporations as a model of enterprise design better suited to deliver for all stakeholders.³⁸</p>
<p>3 Rigorously account for and report on ESG risks and positive/negative stakeholder impacts</p>	<p>Managing and accounting for ESG risks and impacts is increasingly regarded as a fundamental requirement for companies of all sizes. In September 2020, the World Economic Forum's International Business Council (IBC), in collaboration with Deloitte, EY, KPMG and PwC, published a list of ESG metrics and disclosures that all companies should adopt.³⁹ This list, which draws on many existing disclosure frameworks and recommendations, should now become the basis for company disclosures across the board.</p>
<p>4 Link executive remuneration to stakeholder impact metrics</p>	<p>The era of shareholder primacy has seen CEO pay become ever more closely aligned with shareholder returns, while at the same time decoupling from average workers' pay. In 2018, the proportion of the take-home pay of CEOs of S&P 500 companies that came from stock-based compensation exceeded 50% for the first time.⁴⁰ If companies are to be run for the benefit of all stakeholders, the performance of CEOs and other corporate executives needs to be measured – and rewarded – according to a broader set of metrics that reflect the value that companies create for all stakeholders, not just shareholders.⁴¹</p>

<p>5 Integrate non-financial risks and outcomes into investment strategies</p>	<p>Hiro Mizuno, former CIO of Japan's Government Pension Investment Fund, argues that 'large institutional investors... are effectively universal owners, because their portfolios are highly diverse – they have taken a slice through the whole economy and market. The environmental costs incurred by some companies in their portfolios will have an impact on companies elsewhere in the portfolio. This means that asset managers must develop investment strategies that contribute to making the whole system more sustainable.'⁴²</p> <p>A recent report from B Lab and The Shareholder Commons makes a similar case: 'the beneficiaries of large asset funds are diversified investors and have an interest in seeing markets as a whole rise, so that trustees have good reason to work together with other shareholders to both root out business models that harm the economy and to enable collective action that avoid practices that lead to a race to the bottom.'⁴³</p>
<p>6 Ensure asset managers' remuneration reflects stakeholder impact, not just short-term financial gains</p>	<p>In order for capital markets to become effective guardians of stakeholder impact, it will be critical that asset managers' incentives are consistent with the goal of creating value for all stakeholders. A reinterpretation of fiduciary duties (see below) will contribute to this, but effecting real change will require incentives to be aligned all along the investment value chain, from asset owners to asset managers to Boards and executive teams.</p>
<p>7 Incorporate responsibility for managing stakeholder/societal impact into the fiduciary duties of investors and company directors</p>	<p>During the 2010s, significant effort went into incrementally shifting the interpretation of fiduciary duties with regard to material ESG factors. This is an important, but limited, step in the right direction. As the 'Fiduciary Duty in the 21st Century' project's 2019 report makes clear, the increasingly widespread acceptance that material ESG factors should be incorporated into investment decisions means that 'fiduciary duties require consideration of how sustainability issues affect the investment decision, but not how the investment decision affects sustainability.'⁴⁴</p> <p>The next – and potentially more transformative – step is to establish that fiduciaries have a duty to 'understand and incorporate into their decision making the sustainability preferences of beneficiaries/clients, regardless of whether these preferences are financially material.'⁴⁵ This can be thought of as a "double materiality"⁴⁶ perspective that gives fiduciaries a duty to optimize not only financial returns, but also the social and environmental outcomes generated as a result of how capital is deployed.</p>
<p>8 Make disclosure of ESG risks and impacts mandatory and standardized</p>	<p>For markets to price in environmental, social and governance (ESG) risks and impacts, investors, regulators and other market actors require high quality, comprehensive data on those risks and impacts to be available. Currently the data available is patchy, backward-looking and difficult to compare across companies and sectors due to a lack of standardization. Advocates of mandatory reporting standards for ESG performance, such as the Global Investors for Sustainable Development (GISD) Alliance,⁴⁷ argue that incorporating ESG information into mainstream accounting rules would enable all market participants to make better informed decisions.</p>
<p>9 Enforce antitrust rules to ensure free and fair competition</p>	<p>In recent decades, many industries have become increasingly dominated by a small number of very large firms. In the US, between 1997 and 2012, the four largest firms in every sector increased their share of their sector's revenues from 26% to 32%.⁴⁸ One recent book summarizes the impact of such market concentration as follows: 'higher prices, fewer startups, lower productivity, lower wages, higher income inequality, less investment, and the withering of... towns and smaller cities.'⁴⁹ The 'death of competition' is by no means a universal phenomenon: it affects some countries and some sectors more than others. But the impacts of insufficient competition can ripple through supply chains and across borders.</p>
<p>10 Enact and enforce robust laws and regulations to protect all categories of stakeholders: workers, consumers, communities and the environment</p>	<p>To truly reinvent capitalism, actions designed to integrate multi-stakeholder considerations into how businesses and capital markets operate will need to be complemented by action from policymakers and regulators to ensure all categories of stakeholder have appropriate legal protection from abuse. Strong environmental protection, consumer protection and labor rights laws are an essential part of a well-functioning capitalist system. In many countries, decades of deregulation and cuts to public sector budgets mean that laws protecting stakeholder interests are weak and the agencies tasked with enforcing them do not have adequate resources to enforce them.</p>

- 11 **Put a price on externalities when assessing capital expenditures and R&D investments**
- In instances where governments have so far failed to put an adequate price on externalities, companies can nonetheless internalize societal costs (and get ahead of anticipated policy and regulatory changes) by applying an internal price. The most common example of this principle in action today is the widespread adoption by companies of internal carbon prices.⁵⁰ Assigning value to unpriced externalities in internal decision making is seen by some businesses as a way of preparing for future changes in government policy. It can also enhance businesses' credibility with policymakers in calling for regulation that ensures externalities are priced.
- 12 **Align investment strategies with clients'/beneficiaries' non-financial preferences, as well as their financial interests**
- Saker Nusseibeh, CEO of Federated Hermes, an investment management firm, makes the case that those managing money on behalf of future retirees should prioritize 'holistic returns' rather than merely financial returns.⁵¹ That is to say: investment strategies should recognize that social and environmental outcomes have a profound impact on the wellbeing of individual beneficiaries – and should be crafted to optimize these outcomes, alongside generating a financial return. This reinterpretation of the purpose of investing has implications for all aspects of investment strategy – from portfolio construction to stewardship practices.
- 13 **Update valuation tools to incorporate non-financial forms of capital into decision making**
- Investors' failure to adequately factor non-financial performance into their decision making may be more than just a problem of inadequate data: in some cases, faulty assumptions appear to be hardwired into the tools that mainstream capital markets actors use to make investment decisions and allocate capital.
- For example, Steve Waygood, Chief Responsible Investment Officer at Aviva Investors, argues that the near-universal use of Discounted Cash Flow (DCF) analysis is a threat to sustainability. DCF, he comments, 'ignores social capital as it is external to the corporate profit and loss statement... And it assumes away the need to preserve natural capital by assuming all investments can grow infinitely with its Terminal Value. We are left with millions of professional investors managing trillions of assets on our behalf, all of which largely ignore the one planet boundary condition.'⁵²
- 14 **Update legal frameworks to make influence on corporate strategy contingent on having "skin in the game"**
- Asymmetries between risk and reward are rife in today's markets. Martin Wolf of the Financial Times points out that, under current laws, a publicly-listed company is required 'to serve the interests of those least committed to it, while control is also entrusted to those least knowledgeable about its activities and at least risk of damage by its failure.'⁵³
- Columbia Law School Professor Katharina Pistor argues that 'limited liability insulates investors from the externalities created by the companies they own,' and advocates removing some of the limits on shareholders' liability for damage to the environment caused by companies they invest in.⁵⁴ Dominic Hofstetter, Director of Capital and Investment at Climate-KIC, argues for the promotion of an existing but rare hybrid legal form – the limited partnership or Kommanditgesellschaft – in which managers are personally liable for all debt and losses, but investors are only exposed to the extent of their investment.⁵⁵ Others advocate creating different classes of equity holders with different levels of liability, matched to their level of influence and control over corporate strategy.⁵⁶
- 15 **Ensure market prices reflect the full social cost and/or benefit of externalities**
- Contemporary capitalism is generating vast negative externalities that, for the most part, go either unpriced or priced at too low a level. The scale of these negative externalities is such that our economy may now be 'more market failure than market.'⁵⁷ A 2013 study by Trucost found that, if you factor in environmental costs, almost no industry in the world is profitable.⁵⁸ Another study, published the following year, estimated that the Earth's annual ecosystem services had been depleted by USD \$20 trillion between 1997 and 2011.⁵⁹
- The failure of markets to properly price environmental damage (or to value restoration and regeneration) means that companies face weak incentives to mitigate this damage. Furthermore, in the absence of effective pricing, competitive market dynamics – one of capitalism's core features – encourage companies to externalize costs ever more aggressively.

LONG-TERM

- 16 **End quarterly earnings guidance and instead actively engage with shareholders around long-term strategy, including the need to preserve and enhance non-financial forms of capital**
- As Dominic Barton, then Global Managing Partner of McKinsey, pointed out back in 2011, excessive focus on meeting quarterly earnings targets is counterproductive: 'When McKinsey's finance experts deconstruct the value expectations embedded in share prices, we typically find that 70% to 90% of a company's value is related to cash flows expected three or more years out. If the vast majority of most firms' value depends on results more than three years from now, but management is preoccupied with what's reportable three months from now, then capitalism has a problem.'⁶⁰ Barton and other advocates of long-term capitalism have argued that companies should stop issuing quarterly earnings guidance – as Unilever and others have done – and instead focus on articulating a long-term strategy to investors, seeking to attract investors with a long-term, buy-and-hold orientation.
- 17 **Ensure all dividend payments and share buybacks are consistent with longterm strategy and value creation**
- Unlimited share buybacks became legal in the US as recently as 1982. Critics of the now widespread use of buybacks – such as economist William Lazonick – argue that they encourage short-termism and 'undermine the quest for equitable and stable economic growth.'⁶¹ In too many instances, buybacks appear to have become a way to boost stock price performance in the short term, but this comes at a long-term cost: buybacks reduce the amount of money companies have to invest in R&D and innovation. They also diminish cash reserves that may be needed to weather an economic downturn. Lazonick and others argue for an outright ban on buybacks done as open-market repurchases. Whether or not a ban would be beneficial, it is certainly incumbent on all companies to ensure they use buybacks responsibly in a way that aligns with their long-term strategy and approach to value creation for all stakeholders.
- 18 **Reduce the share of executive pay that is tethered to stock price**
- The tendency for executive pay to be closely aligned with shareholder returns – and, particularly, short-term stock price performance – inevitably creates an incentive for those running companies to focus on the short term. With this in mind, Judy Samuelson of the Aspen Institute has called on companies to "dampen down the intense focus on stock price in CEO pay."⁶² Dominic Barton argued back in 2011 for linking compensation to 'the fundamental drivers of long-term value, such as innovation and efficiency, not just to share price.'⁶³
- 19 **Update valuation tools so that they do not systematically discount the interests of future generations**
- Discount rates are a core feature of financial analysis – and the appropriate level for discount rates to be set at is an ongoing debate. What's clear, however, is that, currently, the very long-term future is largely excluded from investors' analysis as a result of the widespread use of tools like Discounted Cash Flow analysis and the benchmark discount rates that underpin it.
- 20 **Asset managers and investment consultants should be remunerated and incentivized on the basis of long-term financial and non-financial performance**
- Many asset owners and end beneficiaries have a long-term orientation, but that outlook is often not reflected in the incentives that drive asset managers. As Dominic Barton explains: 'Fund trustees, often advised by investment consultants, assess their money managers' performance relative to benchmark indices and offer only short-term contracts. Those managers' compensation is linked to the amount of assets they manage, which typically rises when short-term performance is strong. Not surprisingly, then, money managers focus on such performance – and pass this emphasis along to the companies in which they invest.'⁶⁴ Correcting these misaligned incentives is a critical part of what's needed to make capitalism as a whole more long-term.
- 21 **Use fiscal policy to create incentives for investors to hold onto shares for longer periods**
- One suggestion that has been mooted by multiple critics of contemporary capitalism's short-termism is reforming capital gains tax to introduce a variable rate that penalizes short holding periods, thereby incentivizing longer-term commitment from shareholders.
- 22 **Increase influence of long-term "anchor" shareholders in corporate governance**
- To give long-term shareholders more influence over corporate strategy than short term 'activist' shareholders, management thinker Roger L. Martin argues that voting rights should be based not just on the number of shares held, but the duration for which those shares are held.⁶⁵ A version of this idea has been implemented in France, where investors who have held shares in a company for at least two years get double voting rights.⁶⁶

REGENERATIVE

- 23 **Develop products, services and business models that actively contribute to the health of economies, societies and the environment**
- For capitalism as a whole to become regenerative, individual businesses will need to integrate societal benefit into the core of their products, services and business models. A regenerative business is one that actively contributes to the health of the wider social, economic and environmental systems it is nested within. Advocates of regenerative capitalism emphasize that this can be achieved by designing products and business models in ways that mimic nature (biomimicry). The Capital Institute identifies eight principles of systemic health that should inform both business model and economic system design.⁶⁷

- 24 **Channel capital towards new business formation and critical infrastructure projects that deliver social and/or environmental benefits** In a regenerative economy, the finance sector ‘must be understood as a subsystem in service to a healthy real economy.’⁶⁸ This means that the core purpose of finance is to channel capital into new business formation and critical infrastructure projects – specifically those with clear social and/or environmental benefits baked in. This, rather than speculation in secondary markets, should be the primary focus for investors in a regenerative capitalist system.
- 25 **Shift the burden of taxation from “goods” (eg., employment) to “bads” (eg., pollution)** The Ex’tax Project advocates increasing taxes on natural resources and pollution, and using the revenues to lower the tax burden on labor, thereby incentivizing a reduction in resource consumption and pollution, accompanied by an increase in employment.⁶⁹
- Another proposed reform is to equalize capital gains and income tax rates.⁷⁰ In many countries, the latter is higher than the former meaning that those who derive income from capital gains are taxed at a lower rate than ordinary workers. Since the already wealthy are most likely to derive a significant proportion of their income from capital gains, this discrepancy in tax rates fuels inequality.
- 26 **Disincentivize financial speculation and incentivize investment in real economy projects, especially those with clear social and/or environmental benefits** John Fullerton of the Capital Institute argues that, in blurring the distinction between investment and financial speculation, we have degraded ‘the potential of a long-term relationship between owners and creditors on one hand, and enterprise on the other, to the level of an abstract transaction in pursuit of only short-term satisfaction.’⁷¹ While some speculation is beneficial as it enables price discovery and market efficiency, current financial markets are skewed heavily towards speculation at the expense of real economy investment. Meaningful disincentives to speculation would therefore “crowd in” capital to the real economy.⁷² This could be achieved, for example, through a broadly applied financial transactions tax.
- 27 **Reduce or remove incentives for companies to prefer debt to equity capital** Financial leverage enhances capital efficiency but reduces systemic resiliency. Most corporate tax systems around the world give companies an incentive to employ debt finance in preference to equity (due to the tax deductibility of interest payments). This distortion – effectively an implicit subsidy for debt – encourages companies to adopt excessively high levels of leverage, leaving both companies and their creditors more exposed to failure. Professor Colin Mayer of Saïd Business School argues for ‘equaliz[ing] the tax treatment of equity and debt in the corporate tax system, firstly to encourage banks to hold more equity and secondly to encourage companies to hold less debt. This would promote better-capitalized banks and less leveraged corporations.’⁷³

ACCOUNTABLE

- 28 **Contribute to the health of non-market institutions that are needed to provide public goods and keep market failures in check by paying taxes in a fair and transparent way** The health of capitalism is inseparable from the health of the institutions that exist to provide public goods and ensure that markets are free and fair. Paying taxes is one of the main ways in which companies contribute to society. The World Economic Forum’s 2020 Davos Manifesto states that paying its fair share of taxes is part of the core purpose of a corporation.⁷⁴ It is incumbent upon responsible companies to put this principle into practice and be transparent about their tax arrangements.
- 29 **Adopt responsible stewardship practices and engage with corporate management on ESG issues** Today’s capital markets have been described as “capitalism without capitalists”.⁷⁵ This is because those providing financial capital to businesses do not, for the most part, take real responsibility or exercise real control over the companies that they invest in.
- Federated Hermes, an investment management firm, makes the case that ‘the principal role of investment management is to ensure that investors’ capital is deployed to deliver sustainable wealth creation. Active stewardship is the best way to achieve this, but today it only commands a small proportion of the resources available within investment management firms. This needs to change.’⁷⁶ Initiatives like Climate Action 100+⁷⁷ and the Net-Zero Asset Owner Alliance⁷⁸ have the potential to play a major role in enabling a step change in stewardship practices. Fulfilling that potential, however, will require member institutions to commit serious resources to the hard work of engaging with companies on an ongoing basis.
- 30 **Encourage asset owners and end beneficiaries to state clear preferences with regard to non-financial outcomes and embed these preferences in investors’ mandates and responsibilities** For changes to fiduciary duty requiring investors to consider the non-financial preferences of their clients and beneficiaries to have the desired effect, financial institutions will need to go to much greater lengths than is currently the norm to find out what those preferences are. Initiatives like the UK-based Make My Money Matter campaign⁷⁹ are beginning to raise public consciousness about the fact that pension fund beneficiaries can state a preference about what non-financial outcomes are integrated into the way their money is managed. But there is a long way to go to get to a world where end beneficiaries non-financial preferences are systematically incorporated into asset managers’ decision making.

31 Overhaul the international tax system to make tax avoidance harder

The International Monetary Fund (IMF) estimates that tax havens cost governments USD \$500-600 billion a year in lost corporate tax revenue.⁸⁰ Firms that pursue aggressive tax avoidance strategies are able to generate an inflated rate of return relative to those with responsible tax policies. At the same time, tax avoidance undermines both the effectiveness and legitimacy of governments. The lost revenue makes it harder for governments to fund and invest in public goods, such as education and healthcare, that are essential for national and corporate long-term prosperity. Meanwhile, the perception that large companies and wealthy individuals can avoid paying their fair share of taxes fuels a widespread belief amongst ordinary citizens that 'the system' is rigged against them, which in turn fuels populism.

Since 2008, the OECD has led an ambitious international effort to 'put an end to tax avoidance strategies that exploit gaps and mismatches in tax rules.'⁸¹ The OECD is focused on two priorities: first, strengthening the right of countries to tax corporate income from sales on their territories, regardless of where the company is legally located; and second, setting a minimum level of tax applied to all multinationals. These reforms, it estimates, could raise corporate tax revenues by USD \$100 billion annually.

32 Strengthen multilateral institutions designed to address systemic risks and to coordinate policy responses to market failures

When multilateral institutions are unable to coordinate effective action to tackle systemic failures, markets tend to run wild, creating vast negative externalities. Business can and should publicly support existing multilateral efforts to address market failures – from the OECD's work on tax avoidance to the United Nations Framework Convention on Climate Change (UNFCCC) work on global climate action – as well as calling for institutional reform where existing bodies are falling short.

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For more information on the update of WBCSD's Vision 2050 visit www.wbcسد.org/vision-2050-refresh

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