

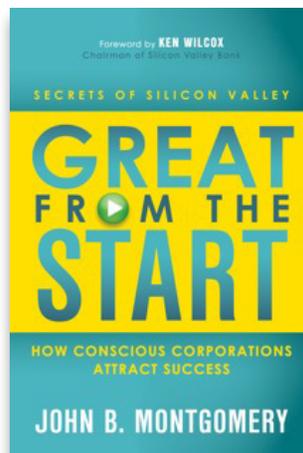


The corporation is the innovation

AN EXCERPT FROM:

Great From the Start: How Conscious Corporations Attract Success

EPILOGUE



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The Law of Success



EPILOGUE

Corporations have no consciences, no beliefs, no feelings, no thoughts, no desires. Corporations help structure and facilitate the activities of human beings, to be sure, and their “personhood” often serves as a useful legal fiction. But they are not themselves members of “We the People” by whom and for whom our Constitution was established.

—John Stevens, US Supreme Court justice,
Citizens United v. Federal Election Commission

The global economic system nearly collapsed while I was writing this book. Although it is tempting to blame the wizards of Wall Street for this calamity, all of us must bear some responsibility because we have created a global economy that is populated by corporations that operate without consciences. Free-market economists have lulled those of us who make our livings in corporations into abdicating our moral responsibilities by blindly trusting that Adam Smith’s invisible hand will miraculously protect the public good from our corporations. The stark truth is that external regulation is not enough to protect society from the unconscionable behavior of corporations.

The modern corporation has no conscience, and you invite disaster if you operate your business without a conscience in today’s massively interdependent global economy because you won’t have an ethical framework to help your company make the tough choices. Having a conscience will help your company avoid decisions that make economic sense but destroy the goodwill of the business. Without a conscience, for example, you may decide to fire 300 people and move manufacturing to a distant communist country to improve your margins, but in so doing you would demoralize your remaining employees,

damage your company's culture, and destroy your relationships with strategic partners, suppliers, and the communities that have sustained your business. A conscience helps your company make the right choices.

In addition, you are doing business in a glass house. If your corporation acts unconscionably, as Toyota is perceived to have done recently by selling vehicles with dangerous accelerator problems, the world will hear about it instantly. Unless you proactively design a conscience, bloggers and websites like Twitter and Avaaz.org will be your corporation's default conscience. If you rely on the retroactive conscience of public approbation, you risk destroying the goodwill of your business if it fails to act in good conscience. British Petroleum, for example, damaged its reputation and caused its stockholders to suffer billions of dollars of lost stock value when its decision to cut corners to prematurely activate an undersea oil well in the Gulf of Mexico led to a massive oil spill.

Once upon a time, the corporation had a conscience, but it disappeared over the centuries. You can, however, design your company with a sophisticated conscience that can help you make the tough decisions. First, it is helpful to understand how the corporation lost its conscience. If you plan to form a corporation, you will actually be doing business in an entity that was designed for commerce in the Middle Ages. The amazing thing about the corporation is that it is such a brilliant agent of commerce that its original form has endured for centuries. Unfortunately, that form lacks an internal conscience that is suitable for doing business in the interconnected world of the twenty-first century.

The Corporation in the Age of Exploration

The corporation began its existence in medieval Europe with an external conscience provided by the king. In those days, kings granted charters to corporations with royal monopolies to pursue particular commercial purposes. The corporation enabled a king to extend his power beyond the limited resources of the treasury by allowing a group of individuals to raise capital for a commercial venture that also advanced the political and economic interests of the monarchy.

During the Age of Exploration from the fifteenth to the eighteenth century, the corporation served European monarchies as the agent of global exploration and territorial conquest. Canada's Hudson's Bay Company, for example, received

its charter from the king of England in 1670 with a monopoly to exploit the valuable fur trade in the Hudson Bay watershed. The company helped the British monarchy extend the reach of its empire. At one time the Hudson's Bay Company controlled 15 percent of the landmass of North America.

To control the corporation, the king ruled it from the outside. If the corporation were a person, the king was the head and the corporation was the body. Separating the corporate body from its head ensured that it would not threaten the king's power.

If a corporation behaved unconscionably, the king could simply revoke its charter. Because the threat of revocation served as an external conscience, the corporation was created without an internal one. Because the king was the ultimate authority under the Divine Right of Kings, a doctrine that held that a monarch derived his right to rule from God, the corporation's external conscience, in theory, was the highest conscience on the planet.

The Corporation in the Age of Enlightenment

The corporation lost its supreme external conscience during the Age of Enlightenment in the eighteenth century. Reason debunked the legitimacy of the Divine Right of Kings, and Europe diffused the power of its monarchs into executive, legislative, and judicial branches of government. The external conscience function served by the king passed to these new entities. Creating a corporation no longer required that the king approve the charter.

As a holder of the lineage of English common law, the United States inherited the corporate architecture that separated the corporation from its conscience, but the doctrine of separation of church and state diminished the power of that conscience because the state was no longer the moral authority. In the early years of the republic, state legislatures exercised the conscience function formerly exercised by the king. Forming a corporation required formal legislation to approve the charter. Legislatures authorized corporations as quasi-public monopolies designed to serve a social function, like building a toll road, and closely supervised them to ensure that their behaviors didn't vary from the proscribed purposes set forth in their charters. Often the legislature limited the

lifetime of a corporation to a term of 10 to 20 years. These checks and balances provided the functional equivalent of the conscience of the king.⁸

The Corporation in the Age of Industry

After 1800 legislatures shifted from approving corporations with inherent state-granted monopolies to allow for free incorporation under general laws. Free incorporation released corporations from the cumbersome process of having state legislatures approve their charters, and it reduced legislatures' external conscience function.

During the nineteenth century, the US Supreme Court further diminished the corporation's external conscience by reducing the power of state legislatures to revoke or alter a corporation's charter.⁹ The application of the principle of limited liability in the mid-1800s eliminated another aspect of the corporation's conscience. Before limited liability, a corporation's stockholders faced unlimited liability for its debts, and its directors and officers bore personal responsibility for its actions. Courts also granted corporations some of the constitutional rights of individual citizens.¹⁰ These developments, coupled with the freedom of incorporation, made it much easier for corporations to raise capital and proliferated their adoption as agents of the Age of Industry in the nineteenth and twentieth centuries.

Without legislatures to hold them in check and an internal conscience to guide them, corporations increasingly behaved in ways that harmed society. As a result, the external conscience function provided by legislatures shifted to being reactive. Legislatures responded to corporate transgressions by imposing external regulations on them. Abusive monopolies, for example, fostered antitrust laws, and pollution fostered laws that protect the environment. This has been an expensive and inefficient approach because it is harder to correct damage after it has occurred than to prevent it in the first place.

In response to management transgressions, courts imposed fiduciary duties on directors of corporations to ensure that corporate actions considered the interests of stockholders. Fiduciary responsibilities, like the duty of care and

8 See *Citizens United v. Federal Election Commission*, 558 US _____ (2010), minority opinion of Justice Stevens, pages 121 to 125 for an overview of the early history of the corporation in America. <http://www.supremecourt.gov/opinions/09pdf/08-205.pdf>.

9 See *Trustees of Dartmouth College v. Woodward*, 17 US 518 (1819).

10 See *Santa Clara County v. Southern Pacific Railroad Co.*, 118 US 394 (1886).

the duty of loyalty, formed a primitive code of conduct to guide the board of directors to exercise the corporation's conscience. This internal conscience is a default conscience, however, because it is implied by common-law precedent rather than expressly required by statute.

Some companies discovered that having a conscience was good business. Johnson & Johnson adopted its famous credo¹¹ in 1943 shortly before it became a public company. The credo recognizes that the company's responsibilities extend not only to its stockholders but also to its employees, its customers, its suppliers and distributors, the community in which it does business, and the world. The credo has served as Johnson & Johnson's moral compass by defining the values by which it conducts business with its multiple stakeholders. Having the credo enabled Johnson & Johnson to preserve its enterprise value by doing the right thing by recalling every bottle of Tylenol after a tampering scare in 1982.

The Corporation in the Twenty-First Century

You are asking for trouble if you rely exclusively on the fiduciary duties of the board of directors to stockholders as your corporation's conscience. That's like using the temperature gauge to operate your car. Just as your car's range of mobility is restricted when its radiator is about to boil over, your corporation's range of strategic options will be limited if you rely on only your fiduciary duties to stockholders to dictate your actions. Your company will tend to focus on short-term financial results and ignore the long-term effects of its behavior on its other stakeholders.

Many companies now recognize that the fiduciary duties of management to stockholders are only a subset of a code of conduct and a system of values that extends to all stakeholders. In the early 2000s, a movement called *conscious capitalism* emerged to evolve a more enlightened form of capitalism. At the core of this movement is the recognition that a corporation is not the traditional duality of the Age of Industry—a corporation and its stockholders—but rather a complex, interdependent ecosystem comprising the corporation and all of its stakeholders. Companies that follow the tenets of conscious capitalism, like

11 <http://www.jnj.com/wps/wcm/connect/c7933f004f5563df9e22be1bb31559c7/ourcredo.pdf?MOD=AJPERES>.

Whole Foods Market, have made the value systems by which they conduct their business with all their stakeholders the core driver of their being.

You will have a competitive advantage if you design your corporation to have a sophisticated internal conscience to supplement the fiduciary duties of directors to stockholders. To succeed in an economic system that understands the limits of its natural resources and recognizes the need to protect the environment will require you to anticipate the consequences of your company's actions like never before. You'll have to make very tough decisions that will require a strong moral compass.

This book shows how you can articulate your corporation's core values to serve as the code of conduct for management to use to exercise the company's conscience. You can internalize the conscience of the king to endow your corporation with a sophisticated internal probity—the highest form of conscience on the planet—to help you preserve and protect the extraordinary value that you will create.

