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Many happy returns?

What firms are for

The framework for thinking about business and capitalism is hopelessly outdated, argues a new book

Photograph: Mark Henley/ Panos PIctures.

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The Corporation in the 21st Century. By John Kay. *Yale University Press; 448 pages; $35. Profile; £25*

Who owns a company? The usual answer is that shareholders do. Yet they do not own it in the same way they might own, say, an umbrella. The umbrella's owner has acquired some rights: to possess it, use it and receive any income from renting it out, for instance.

Buy shares in Amazon, and you have indeed purchased all these rights over the shares. But even if you clubbed together with most of the other shareholders, you would not be able to commandeer a data centre or demand your online shopping free. You may own the shares, but you do not own the company. You are entitled to a dividend if its executives declare one; you are not entitled to any cash they get from selling a warehouse.

A new book by John Kay, one of Britain's leading economists, is packed with examples like this. His argument is that many of the ways people talk and think about business have little to do with how today's most important firms actually work but instead describe the capitalism of centuries gone by. Back then, those rich enough to buy factories and machinery called the shots for the companies that needed them. This "tripartite linkage" between personal wealth, ownership of the means of production and control of business "was a defining characteristic of the Industrial Revolution", Mr Kay writes.

The capitalist owner of a cotton mill used to hold the whip hand over its manager because, without the flying shuttles and spinning jennies, no manager could produce cotton. Now things are different. Today's most important means of production are no longer the mechanical equipment needed to make things. Apple is not one of the world's most valuable companies because it runs stellar production lines. Rather, its value comes from intangible factors, such as its employees' knack for design, which allow it to produce things others cannot. People have superseded land and machinery as companies' most productive assets, in other words.

The transformation of the most valuable means of production, argues Mr Kay, is just one reason that shareholders are no longer in charge. A related one is that many of the physical things businesses do need, from offices to IT equipment, are fungible and can be rented from providers of "capital as a service" (such as WeWork for offices, Prologis for warehouses and Foxconn for the machines that assemble iPhones).

Corporate law, meanwhile, has evolved to favour executives over shareholders. Not only do shareholders lack the right to manage a company, but some also struggle to appoint managers of their choosing. The American state of Delaware, wishing to attract big companies, has laws that make it hard for investors to stage hostile takeovers, pack boards with allies or propose their own directors. It has worked: two-thirds of the Fortune 500 list of the world's largest firms are now incorporated there.

As well as analysing this shift in the balance of corporate power, the book offers a lively discussion of what companies are, and what they are for. Texts about purpose in business are all too often waffly and worthy; Mr Kay's is admirably clear. A successful firm is not, he says, the mere "nexus of contracts" described by academics from the 1970s onwards; treating those relationships in purely transactional terms undermines the place of business in society, by making them too short-termist and focused on immediate profits.

If there is one topic on which the author moralises, it is the doctrine that executives should seek to maximise shareholder value. Its proponents have "often ended up destroying not only shareholder value but also the very businesses that their abler and better-motivated predecessors had created," he writes. What follows is a litany of iconic firms that were run into the ground by managers in pursuit of short-term profits, from Imperial Chemical Industries (a 20th-century pharmaceuticals giant that discovered beta-blockers) to Sears, Roebuck (a once-mighty American retailer). The core of Mr Kay's argument is that it is so difficult to decide what will ultimately create or destroy value that executives are better off simply focusing on building "great businesses".

So what is a company for, if not maximising shareholder value? The author's answer is "the flourishing of the multiple stakeholders of the corporation: employees, investors, suppliers and customers, the communities in which it operates and the corporation itself". It would be miserly to contradict such a utopian, if vague, ideal. It is hard, though, to imagine that today's tech giants—whose businesses Mr Kay clearly admires—were built with the flourishing of the communities in which they operate as a primary aim. (Just ask anyone who lives in Silicon Valley.) In fact, all these firms were founded at a time when the idea of maximising shareholder value reigned supreme. They seem to have managed it rather well. ■