

Changing Capitalism and
the Evolution of Corporate Governance

2020.12.3

Director of CFO Education and Research Center
Hitotsubashi University
Kunio Ito

Diastrophism



Changing capitalism

Paradigm underlying capitalism in the 20 century

A. Smith

“Invisible hands”

M. Friedman

Profit maximization as
social responsibility

+ M. Jensen

The paradigm of capitalism

- ✓ Led to the growth in economy, industry and society in the 20 Century.
- ✓ Flourishing of economics and finance theory

Capitalism flourished, but, 、 、 、

Holes in the paradigm

- More than 50 years passed since Friedman addressed his profit maximization theory. What happened?

Unanticipated phenomenon!

- Depended too much upon “invisible hands” (too optimistic) and pursued economy and efficiency in the short-term. It has resulted in “externality” to the extent we cannot accept.

“The tragedy of the commons”

The tragedy of the horizon

Sustainability of firms

Sustainability of society

Sustainability of planet



CRISIS

The symbol is climate change

The rise of “stakeholder capitalism”

✓ 2019.8.19 **Business Roundtable** published a new “Statement on the Purpose of a Corporation.”

✓ Declaring that companies should serve not only their shareholders, but also deliver value to their customers, invest in employees, deal fairly with suppliers and support the communities in which they operate.



World Economic Forum
2020.1

Game change by BlackRock



- Climate risk is investment risk in the near future, and sooner most anticipate, there will be a significant reallocation of capital.
- Every government, company, and shareholders must confront climate change.
- A company cannot achieve long-term profits without embracing purpose and considering the needs of broad range of stakeholders. Ultimately, purpose is the engine of long-term profitability.
- Over time, companies and countries that do not respond to stakeholders and address sustainability risks will encounter growing skepticism from the markets, and in turn, a higher cost of capital.



Divestment? (vs Engagement)

BR声明をどう捉えるか

- Stakeholder capitalism was widely supported in the US after World War . But eventually it failed, because CEOs arbitrarily interpreted “social value” on their own interest. They pretended to take “purpose”, misused companies’ resources and lined their pockets by illegal behavior
(Drucker, Serafeim)

- ”Just Empty Rhetoric?” Andrew Winston, (HBR August 30, 2019)

It would be difficult to implement stakeholder capitalism in a meaningful manner. Eventually it depends upon companies’ disciplined judgement to adopt whether shareholders-first principle or stakeholder capitalism.

(Robert Pozen)

(R. ポーゼン 「米国企業は株主第一主義を捨てるのか？」、
広野彩子 『世界最高峰の経営教室』)

Changing capitalism

Two types of “Digitalization” accelerated by COVID-19

Radical changes in work style and business model
along with digital transformation (DX)



Appearance of “Digital Disruptors”

Another Digitalization

Three scenarios against COVID-19

Scenario 1

Develop vaccine as soon as possible. However, possible variation?

Scenario 2

“New normal” accompanied by social distance, touchless machines, refrain from a variety of parties.

Scenario 3

Specify and verify the route of “cluster” at the outset of occurring of virus in an accurate manner.

Scenario 3

“Already occurred future”

- Taiwan and China have succeeded in coping with COVID-19.
Capitalizing on high level of digital technology and IT.



- Utilize digitalization and online system.
- Insert sensor inside or outside the body, follow and analyze a variety of big data regarding individuals' behaviors and activities with AI, machine learning and so on.

But, “dilemma” awaits

Data-driven smart society by digitalization which can connect all things and items would generate innovations and enhance well-beings.

New inconvenient
truth

If you will not do well, “nightmare” awaits.

- On one hand, digitalization enhances the accumulation of personal data which is necessary to protect the civil rights.
- On the other hand, it would generate threat to the citizens whose personal information would be unduly and unethically utilized by governments, municipalities or companies. = threat to privacy
(ex) the collaboration between Toronto, Canada and Google in 2017

New capitalism

The Rise of “Surveillance capitalism”

**Transformation of corporate governance in
the age of changing capitalism**

Governance to climate change

Capitalism should be changed

- ✓ There is uncertainty about whether stakeholder capitalism would be widely implemented in practice.
- ✓ Companies were sustainable in accordance with Friedman's paradigm which requires companies to realize maximized profit. Now, circumstances have dramatically changed.
- ✓ Once the conditions for companies to survive have changed, management and the board are required to adapt to them.



Climate change:
Our planet would be fragile and dangerous.

“Good capitalism”

- Capitalism is a comprehensive economic system and long lasting in history. However, its types are not uniform. US type, Japanese type, German type, etc.
- Recently those types of capitalism are converging on the similar system in terms of sustainability.
- We should focus on the profound fact that climate change has been more and more critical to the extent that we cannot accept diversity in capitalism.
- The means to resolve the problems are common language and information disclosure.
- The other means to solve “externality” are “visible hands,” or “invisible hands” again?

TCFD as common language for climate change



気候関連財務情報開示 に関するガイダンス 2.0

[TCFD ガイダンス 2.0]

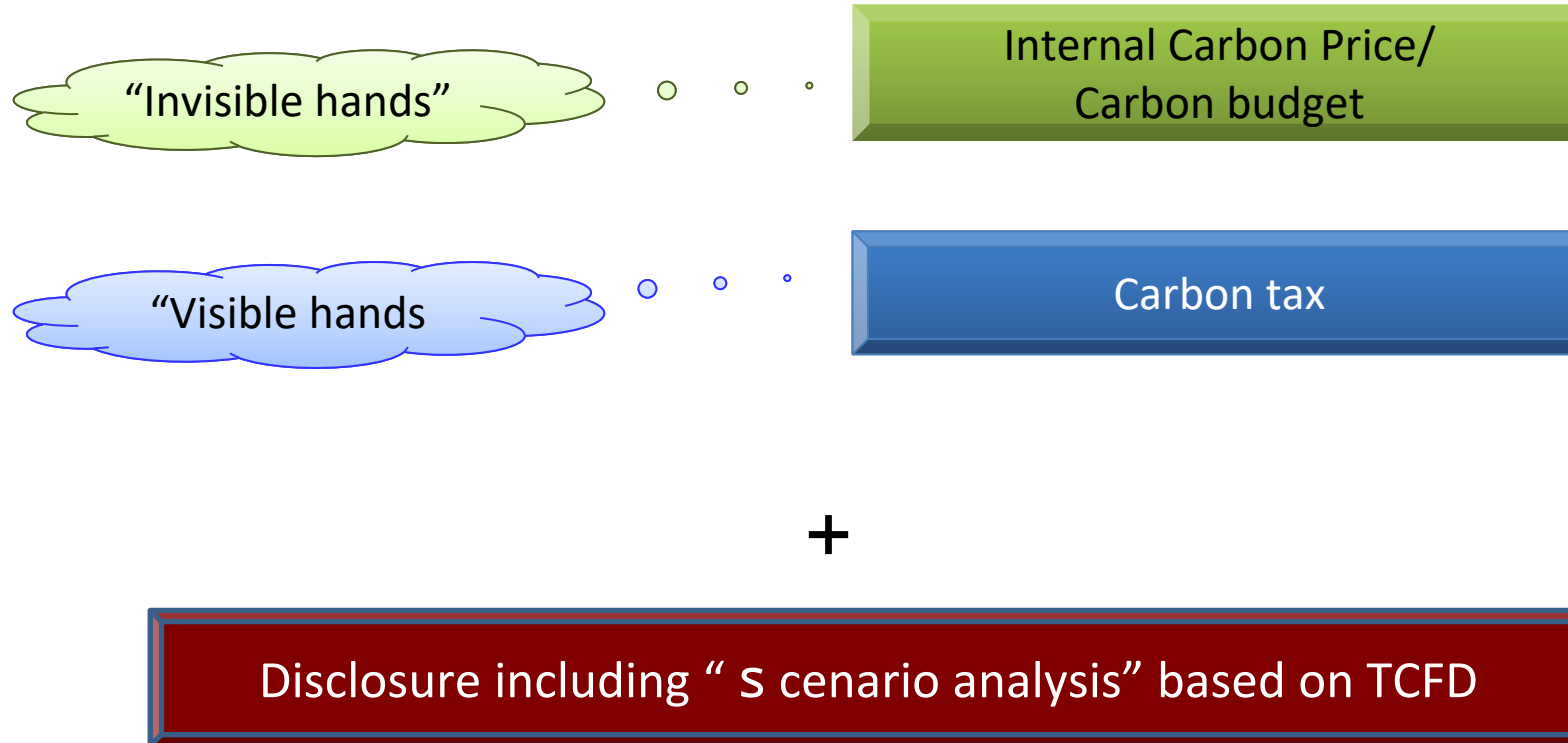
TCFD

2020年7月



TCFD Consortium
2020.7.31

Ambidexterity governance



Governance of digitalism

Digitalization be accelerated in Japan

Digital Governance Code (経産省 「 Society5.0に向けたデジタルガバナンス検討会 」) 2020.6

「 DX MEIGARA 」 選定 (経産省 ・ 東証、当初は 「 攻めのIT経営銘柄 」 、6年目の今年、名称を変更) 2020.8

「 Japan DX Management Roundtable 」 (日本経済新聞社) 2020.12



Governance *for* Innovation

Governance in digitalized society

Integration between capitalism and democracy to prevent
“surveillance capitalism”



“Monitoring democracy”

SDGs 16

Peace, Justice and Strong Institutions

- For digital innovations not to infringe the privacy of individuals, governance should contribute to each safety, security and welfare.
- Develop trust between those who utilize data and individuals.

Governance of Innovation

- Deregulation is necessary so that not only the government but also companies, communities and individuals should be main players.
- With being more digitalized, activities of companies are more based on software and codes, as a result the gap would be created between the reality and rules or regulation which is stipulated in natural language. Companies should play a role to bridge the gap.

Governance Innovation

(「 Study on new governance model in society5.0 」) 22

Towards “collaborative digitalism”

Collaborative digitalism

- Overcome surveillance capitalism
- Disclosure by government and companies
 - Disclosure on which data will be used and what will be the benefits would help individuals be assured.
- Mutual monitoring
 - Representatives of involved parties monitor the situation like “Onbuzuman” system
 - Mutual monitoring by both those who provide data and those who accumulate data.



Global digital governance in the 21 century

SDGs 17

Partnership for the goals

Two pillars of new governance

Digital Governance

+

Climate change governance

Governance Innovation

Collaborative, accountable and transparent capitalism

Doing well by doing good.

Spirit of ESG • SDGs

Governance towards “good stakeholder capitalism”

Transformation of the board

- ✓ Accountability and disclosure to wide range of stakeholders is necessary.
- ✓ Not too biased to specific stakeholders and balancing among stakeholders in the mid-long term is necessary.
- ✓ Enhance the capability searching for corporate behavior which makes companies being sustainable in the long term.
- ✓ Pay more attention to “externality” caused by companies and monitor them to behave in a disciplined and transparent manner.
- ✓ Oversee the distribution of corporate value (profit) among stakeholders as well as creation of corporate value in the mid-long term.
- ✓ Pay more attention to both financial performance and ESG, develop integrated KPI considering both, incorporate it in management practice, and oversee the PDCA cycle.