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The Governance of Corporate Purpose

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Abstract

This paper was written for a Festschrift in honour of Rolf Skog.

Concepts of corporate purpose which have risen to the fore recently emphasize a point which Rolf Skog highlights in his writings about the importance of profits forthe success and continuity of business. But they also question conventional notions of profits where they are earnedat the expense of other partiesand the methods by whichwe both measure profitsand incentivize people to pursue them.

That leads to issues about the governance of corporate purpose which recognizes profit as being derivative of solving, not producing problems, and measurement that needs to account forthe costs of rectifying and avoiding producing problems. In this context, governance moves away from a focus on the agency problem of aligning managerial interests with thoseof their shareholders to one that seeks to promote the identification and implementation of corporate purposes.

The role of the board is then predominantly to oversee the determination of the corporate purpose, ensure that it is the overarching framework within which strategy is formulated, and establish an internal culture, measurement and incentive system that aligns corporate values and metrics with the delivery of purpose. The measurement and incentive systemsrelate not just to inputs and outputs of the firm in a conventional sense but the outcomes and impacts that they have on those whom the company both affects and depends.

The transition of governance and measurement described in this paper is well underway at both national and international levels. There is much work to be done before anew governance and measurement framework emergesbut there is little doubt that we are now witnessing a profound shift inthe nature of the corporate system.

Keywords: Purpose, Profit, Governance, Measurement

JEL Classifications: G3, L2

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Abstract

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1. Purpose

The last few years have seen an explosion of interest in the subject of corporate purpose. This has been prompted by a reconsideration of Milton Friedman's assertion that "there is one and only social purpose of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud".[1] Some regard Friedman's Doctrine as still the linchpin of a capitalist system, others as the source of all evil.

Rolf Skog has played an important part in this debate by writing some seminal articles on the importance of profit.[2] In them he emphasizes two key points. The first is the particular nature of the relationship of shareholders with their firms in which they are the residual claimants bearing the risks of the firm. The second is that to encourage investors to be willing to invest in a company they "will want a guarantee that the business is being managed in a way that generates the biggest surplus possible".[3]

Numerous supposed alternatives to the Friedman have been put forward. However, a brief consideration of them reveals that most do not contradict or reject the Friedman Doctrine. "Enlightened shareholder value" advocates argue that it is long- rather than short-term value that companies should pursue, and, in the process, they should take account of the interests of other stakeholders to the extent that this enhances shareholder value.[4] There is clearly no contradiction here with Friedman's Doctrine.

It is not inconsistent with the view that what matters is shareholders' welfare rather than their wealth if shareholder interests extend beyond just financial value to their health, environment, families and communities.[5] Friedman was quite clear on this when he said: "In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom. Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose—for example, a hospital or school. The manager of such a corporation will not have money profit as his objective but the rendering of certain services. In either case, the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them."[6]

On the same principle, it is consistent with BCorps delivering benefits to other parties which fulfil the objectives of their shareholders. It is consistent with the Business Roundtable 2019 statement of corporate purpose as being about delivering benefits to stakeholders and creating

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[1] Friedman, Milton (September 13, 1970). "A Friedman Doctrine: The Social Responsibility of Business is to Increase Its Profits". *The New York Times Magazine*.
[2] Skog, Rolf. "The Importance of Profit in Company Law – a Comment from a Swedish Perspective" *European Company and Financial Law Review*, vol. 12, no. 4, 2015, pp. 563-571.
[3] P.27, Swedish Corporate Governance Board Annual Report, 2020.
[4] Keay, Andrew (2013), "The Enlightened Shareholder Value and Corporate Governance", 76(5) *Modern Law Review* 940.
[5] Hart, Oliver and Luigi Zingales, (2017), "Companies Should Maximize Shareholder Welfare Not Market Value", *Journal of Law, Finance, and Accounting*, 2, 247–274.
[6] *Op. cit.*

long-term value to shareholders.[7] It is consistent with management theories of shared value and mutuality that deliver value for shareholder and stakeholders in line with shareholder expectations.[8] It is captured in the balanced scorecard of reflecting both long- and short-term shareholder interests and the triple bottom line measurement that it should reflect other stakeholder interests so long as these are consistent with enhanced shareholder value.[9] It is consistent with any theory that fulfils shareholder objectives and does not sacrifice shareholder benefits for those of other stakeholders in the process.

While Friedman would not in general have been supportive of intensified regulation, his doctrine is not inconsistent with those who argue for intensified regulation to protect employees, the environment and society or the adoption of standardized metrics of performance that go beyond financial performance provided that these rules and standards are established by a legitimate democratic process that reflects societal preferences.

None of the above suggest promoting stakeholder interests to the point of diminishing shareholder interests. They all leave the determination of stakeholder interests at the expense of shareholders to regulators and standard setters reflecting societal not director preferences. They emphasize to different degrees the desirability of strengthening regulation or standards, of short over long-term value creation, of shareholder welfare over shareholder wealth, and of the management models that are best designed to promote successful companies which yield superior returns for their shareholders and stakeholders. But those differences in emphasis are not differences in principle of the nature of the firm or the importance of the profit motive.

The way in which the British Academy Future of the Corporation programme defines the purpose of business as being "to produce profitable solutions for the problems of people and planet, not profiting from producing problems for either" is also consistent with the Friedman Doctrine in emphasizing delivering profits and conforming with social norms and regulations.[10] Indeed, it places particular significance on both of these by reinforcing the point that solutions that are not profitable or in violation of social norms and regulations are not legitimate.

So, has the debate been a storm in a teacup and is everyone just talking past each other? The answer is yes in large part, they have been talking past each other, because few (though by no means no-one) doubt the importance of profit and its centrality in a capitalist system. What is not really in question is the significance of profit. What is more pertinent is the meaning of profit and how it is earned. And that relates to two issues – profit and governance.

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[7] Business Roundtable (2019). "Statement on the Purpose of a Corporation", 19 August.

[8] Mayer, Colin and Bruno Roche (2021), *Putting Purpose into Practice: The Economics of Mutuality,* Oxford: Oxford University Press.

[9] Kaplan, Robert, and David Norton (1996), "Using the Balanced Scorecard as a Strategic Management System." *Harvard Business Review,* 75-85; and Elkington, John (1999). *Cannibals with Forks: The Triple Bottom Line of 21st Century Business,* New Society Publishers.

[10] British Academy (2018), "Reforming Business for the 21st Century: A Framework for the Future of the Corporation", London: British Academy, and British Academy (2019), "Principles for Purposeful Business: How to Deliver the Framework for the Future of the Corporation", London: British Academy.

2. Profit

We are familiar with the concept of profit in an accounting and economic sense. Profit in accounting terms is the earnings of a firm that are distributable to its shareholders from its revenues after taking account of the costs of its operations and the capital costs of servicing its liabilities and depreciation of physical assets. Profit in an economic sense also reflects the opportunity cost of forgoing returns on shareholder capital employed that could be earned on alternative investments of similar risks. In other words, profit is the return that shareholders earn on their investments over and above the cost of the capital employed, where the cost of capital reflects the risk adjusted return that can be earned elsewhere.

That notion of the cost of capital then allows for account to be taken of the time profile of revenues and costs earned and incurred at different periods in the future of the present. It gives rise to the notion of the financial value of a company and its investments as being associated with the discounted value of future cash flows (the differences between revenues and costs) where the cash flows are discounted at the cost of capital. That in turn leads to the idea of maximizing the profit of the company by maximizing its value as reflected in its share price of firms at a particular point in time.

That in a nutshell is the notion of the concept of profit and increasing profit that underpins current interpretations of the Friedman Doctrine. There is little dispute of the importance of this, but, though it has not to date been expressed in these terms, and the vast industry of financial economics accepts this notion of profit without question, what underpins nearly all of the debate around the Doctrine is whether it is in fact correct.

The word profit comes from the Latin *prōfectus,* which means progress and success, which in turn comes from *prōficere*, which means "to advance".[11] In other words, the origin of the notion of a profit is in relation to progression and advancement towards the achievement of a goal or objective. The current interpretation of personal financial benefit therefore derives from its association with progress and advancement.

In that context, the validity of the current interpretation of profit cannot be disputed. Where, however, it can reasonably be questioned is when it derives from detriments that are inflicted on others. Put simply where the financial value increment comes from wealth creation then a profit has indeed been earned in the strict sense of progress and advancement. But where it comes in the form of wealth transfers from others then it is associated with loss and regress as well as profit and progress.

At the moment, any consequence of a firm's activities that is not accounted for in its own profits and losses is regarded as "an externality", in other words it is something that the market does not price and is not therefore incorporated in a company's accounts. It is therefore regarded as being beyond the remit of companies and something for private negotiation between the affected parties or public policy to address through regulation or taxation. It is not something that is deemed to bear on the correct definition of the profit of a company.

In the context of profit as reflecting advancement and progress, that is a paradoxical position to hold. Profit is reported where profit is not realized, at least not to the scale at which it is

[11] Source: Oxford English Dictionary.

reported. Where the actions of the firm contravene the law or regulation then it is expected to desist from them but even then, the reported profit of the company is only affected to the extent that the company incurs a cost or liability as a consequence of private negotiation, litigation or public enforcement. It is not incumbent on the firm to incur a cost in remedying the detriment or provide for the possibility of such costs arising in the future.

The natural response to this is to ask why should companies provide for a cost that they are not required to incur? Indeed, according to the Friedman Doctrine and company laws that enshrine shareholder primacy, in an enlightened value as well as any other form, it is incumbent on directors and a reflection of their fiduciary duty to their shareholders to resist incurring such costs unless they could otherwise suffer more serious reputational or other damages as a result of doing so. The notion of profit is then self-fulfilling in limiting relevant costs to those that are legally imposed or reputationally significant.

That is precisely the limitation of even an enlightened value view of the corporation. Companies uphold the interests of their stakeholders only to the extent that this is consistent with enhancing shareholder value. Directors should not and are not legally empowered to go beyond that. That is perfectly reasonable until it is understood that directors should not desist from knowingly imposing detriments on others unless it is illegal or reputationally damaging for them to do so. For example, VW should have persisted with incorporation of defeat devices in their vehicles to evade imposition of emission standards so long as they had confidence in their ability to avoid detection. Even then, the appropriate calculation was to compare profits earned in the meanwhile with the discounted value of regulatory penalties and fines and loss of revenue from reputational damage, weighted by the probability of detection.

It is not surprising that the system promotes repeated deception and gaming because in effect it is designed to encourage it. However, not only is the outcome damaging, the rationale reflects a fundamental misconception of a profit. Profit is not earned when it is knowingly or potentially earned at the expense of others. That is not progress. It is self-enrichment.

If we are to place profit at the heart of our capitalist system, we need to ensure that we have defined it in such a way as to ensure that it accords with a reasonable interpretation of what it means. Simply to say that it is anything that is not illegally earned is not adequate, particularly if every attempt to tighten the regulatory noose provokes cries of anguish and use of those profits to lobby against the changes.

We need a different starting point that a profit is not earned where it derives from imposing detriments on others because it is not an acceptable or legitimate profit even if it is not illegal or reputationally damaging. The definition of corporate purpose to which I referred above that “it produces profitable solutions for problems of people and planet, not profiting from producing problems for either” ensures an alignment between profit and avoidance of detriments, as well as its association with positive benefits.

Who is to say what is detrimental and therefore unacceptable or illegitimate? Do we have to establish a new office of the profit police to achieve this? The answer is absolutely no. It is a move away from relying on regulation or even global accounting standards and recognizing not just what the purpose and profit of a company are but also how their governance arrangements should ensure their fulfilment.

3. Governance

The notion of corporate purpose as being about producing solutions is consistent with approaches that extend the concept of the firm beyond its inputs and outputs to its outcomes and impacts. Producing solutions is shorthand for relating the activities of firms (their inputs and outputs) to the changes they bring about as a consequence of their activities (their outcomes) and the effects that these have on the wellbeing of others (their impacts). Solutions are outcomes that are associated with enhancement of wellbeing and problems with outcomes that are detrimental.

The outcomes are characteristics of firms' activities that link activities to impacts. They are similar to, but distinct from, the notion of product characteristics that became fashionable in industrial economics in the 1970s, relating firms' products to the preferences of consumers and therefore their product demands.[12] The problem-solving characteristic of products replaces the more traditional characteristics view of products which looks at them in terms of the factors that are relevant to consumer demands. Problem solving is actions that create outcomes which are associated with enhancement of wellbeing of others.

Sticking to the car example, a car company produces vehicles that allow passengers to move at speed and comfort but produce noise and emissions. The inputs are the resources used in producing the outputs which are the cars. The outcomes are speed and comfort of travel, and noise and pollution. The impacts are positive solutions to problems of mobility and enjoyment for passengers, and negative environmental detriments for pedestrians and residents.

There are therefore two elements in terms of evaluating the performance of a firm. The first is to determine the changes that a company brings about as a consequence of what it does as well as what it produces. The second is then to identify the effects of those on the wellbeing of affected parties. The first relates to the internal governance and the second to the external governance and engagement with other parties.

Governance in a conventional context of promoting shareholder value is associated with the alignment of managerial and in particular executive and non-executive interests with those of shareholders. It is designed to ensure that companies are focused on enhancing the financial performance and profitability of firms. As Rolf Skog explained, that derives from the view that shareholders are the residual claimants and therefore can reasonably expect that the firm is run to reflect their interests in value creation.

That remains true in purposeful businesses whose objective is to produce profitable solutions. However, there are two other important elements that arise in this context and affect the appropriate nature of the governance of a corporation. First, there is a need to generate profits from producing solutions to problems. Second, there is a requirement to ensure that profits do not derive from inflicting detriments on others. If that is the case, then there is a powerful alignment between what is beneficial for firms and their shareholders and what is beneficial for other parties. There is no conflict from either the definition of profits or the activities of firms.

[12] Lancaster, K. (1966), "A New Approach to Consumer Theory", *Journal of Political Economy*, 74, 132-57.

The creation of profits from producing solutions shifts the focus of governance away from simply aligning the interests of boards with profits to the process of producing solutions from which profits derive. It appropriately recognizes that profits are derivative of the process of solving problems not the purpose of business itself. In particular it focuses governance on the process of identifying the problems that companies are there to solve, whose problems, how they should solve them, and what makes those companies particularly well suited to solve the problems.

The avoidance of problems requires a good understanding of the outcomes of the firm's activities and the determinants of the wellbeing of those who are affected by its outcomes. What are the detriments associated with the company's activities and what are the potential problems that could emerge at some stage in the future? This involves a careful reflection of what can go wrong not just from the point of view of the firm's customers but also its employees, suppliers, communities and societies.

The first positive aspect of producing solutions relates to the governance of the process of formulating and implementing a company's purpose, and those parties on which the firm depends for delivery of its purpose. What problems is it seeking to solve, whose problems and how will it engage with those on whom it depends in solving those problems. The second aspect of avoiding producing problems relates to the accountability of the firm to those who are impacted by its activities and the determination of the degree to which it is fulfilling its purpose of producing solutions not problems and profiting in the process of doing this.

The required governance arrangements of board have been succinctly summarized in the five principles described in the SCORE framework of the Enacting Purpose Initiative, where the five letters of SCORE stand for:[13]

1. Simplifying and clarifying the corporate purpose.
2. Connecting corporate purpose with a company's strategy and capital allocation decisions.
3. Owning purpose by the board, which puts in place appropriate structures, control systems and processes for enacting purpose.
4. Rewarding people in the organization in relation to measures of profits and performance that evaluate the success of the organisation in delivering on its purpose.
5. Exemplifying organisational purpose through communication and narratives that bring the purpose to life and demonstrate its authenticity.

Corporate governance is not therefore simply about aligning managerial interests with those of their shareholders but with their corporate purposes. This is recognized in the recent revisions that have been made to the UK Corporate Governance Code. Britain led the way in the development of principles of corporate governance following the recommendations of the Cadbury Committee in 1992. These became the basis of corporate governance codes that were adopted around the world, including in the OECD Principles of Corporate Governance.[14] However, in July 2018, the Financial Reporting Council issued a revised Corporate Governance Code the second and third principles of which state that: "the board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the

[13] Enacting Purpose Initiative (2020), "Enacting Purpose within the Modern Corporation: A Framework for Boards of Directors".
[14] G20/OECD (2015), "Principles of Corporate Governance", Paris: OECD.

desired culture……..The board of directors should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them." [15]

This is a concise summary of what is required of directors, namely that they should determine their company purposes, ensure that their values and strategy are aligned with them, lead the organization by example from the top, embed values and strategy throughout their organizations, allocate the necessary resources and investments required to support them, and measure performance of the company and its people against them.

What the new corporate governance code does not discuss at length is the nature of the accountability associated with these principles. The board is conventionally accountable to its shareholders and shareholder meetings. However, a purpose of producing profitable solutions and not profiting from producing problems extends accountability to a wider body of beneficiaries than just shareholders. In other words, boards engagement and accountability should be aligned with the overall impact and resourcing, not just the financing, of its activities.

Achievement of the purpose requires a sense of ownership by everyone in the organization, not just those with formal ownership rights and those at the top, but throughout from the board to the shop floor. They should all understand how the purpose of their part of the organization contributes to the overall corporate purpose and they should feel supported in achieving that through the resources that are provided, the investments that are made, and the way in which their activities and performance are measured.

There should therefore be a consistency in terms of not just the values and culture of the organization with its purpose but all aspects of its management and measurement. The executive and board should not appear remote to even the most junior members of the organization but instead an integral part of a team that is collectively delivering the purpose. They like everyone else in the company should be accountable for their activities to those within as well as outside the organization.

The function of the leadership of a company is not simply to be commanders-in-chief but more significantly communicators-in-chief. They are there to communicate the importance and meaning of the company's purpose and inspire everyone through narratives and examples of how the company is helping to address meaningful challenges. They should demonstrate a high-level of integrity in openly discussing the problems and failures as well as the successes that are being encountered. They should celebrate the contributions and achievements of people throughout the organization and recognize and assist those who are struggling with understanding or fulfilling their objectives.

Lending credibility to the company's purpose requires alignment of incentives, remuneration and promotion with it. Culture and values are important but so too are the material rewards that people take home. Key to this is the measurement system and ensuring that it aligns remuneration and promotion with delivery of the corporate purpose.

[15] Financial Reporting Council (2018), "The UK Corporate Governance Code", FRC, London.

4. Measurement

Measurement is currently reflected in accounting for the financial and physical assets of a company. However, a growing proportion of companies' assets are intangible rather than tangible - human, social and natural - rather than physical assets, and outside as well within the legal boundaries of the firm. Accounting to date has not kept pace with these developments and distorts reporting of the allocation of resources and investments.[16]

In particular, there is insufficient recognition of the investments associated with expenditures on people, societies and environments outside as well as within firms in their supply chains, local communities and natural world. These are assets over which companies do not necessarily have legal claims but are still critical to the successful functioning of a company and fulfilment of its purpose. A failure to recognize them as assets rather than current expenditure leads to an overstatement of their costs and an understatement of their enhancement of the productive potential of a firm. In other words, it results in a deficient allocation of resources to these activities.

Notice that what is suggested here differs from many current proposals to reform accounting and reporting which emphasize valuations of assets along conventional lines of present values of projected future benefits and earnings. These are subject to serious problems of measurement, accuracy, validation and discounting that fail to meet normal standards of accounting. Instead, the approach here uses actual expenditures rather projected benefits at hypothesized prices and therefore conforms to conventional cost-based accounting principles.

It is also relevant to performance measurement. Currently, performance is measured in relation to profits net of the costs of maintaining physical assets of firms. However, the growing significance of other non-physical assets implies that they should be measured net of the costs of maintaining human, social and natural as well as physical assets. The maintenance of their productive potential is as important to the firm as its physical assets.[17]

More generally, performance should be measured in relation to the company's success in fulfilling its purpose. Failure to do so should create a requirement to provide for the expenditures needed to remedy the deficiency. By so doing, the company reduces its stated profits and its earnings available for distribution to its shareholders. It therefore creates a reserve to rectify underperformance.

Barby et al (2021) describe the three steps involved in doing this.[18] The first is the determination of motives of the company as reflected in its purpose – why it exists – and the relation of that to its mission as reflected in its strategy, its vision of where it aspires to get to, and its values that underpin how it operates.

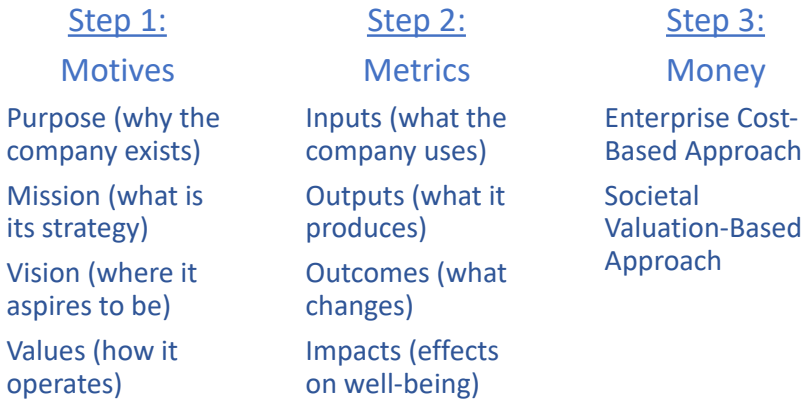
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[16] See Richard Barker (2020), "Accounting for Natural Capital" in Colin Mayer and Bruno Roche (eds), *op. cit.*

[17] Robert Eccles and Francois Laurent (2020), "Implementing a Mutual Profit and Loss" and Robert Eccles and Judith Stroehle (2020), "The Impact of Mutual Profit on Business Behaviour" in Colin Mayer and Bruno Roche (eds), *op. cit.*

[18] Barby, Clara, Richard Barker, Ronald Cohen, Robert Eccles, Christian Heller, Colin Mayer, Bruno Roche, George Serafeim, Judith Stroehle, Rupert Younger, and Robert Zochowski (2021), "Measuring Purpose: An Integrated Framework", SSRN

Figure 1: Motives, Metrics & Money



(Source: Barby, C et al (2021))

The second step is to measure the company's inputs, outputs, outcomes and impacts, and the third is to convert them into monetary terms in both cost-based accounts that are predominantly used for internal management purposes, and valuations that external parties such as investors, stakeholders, regulators and policymakers undertake based on the company's external quantitative and qualitative reporting. Particularly important in this is the derivation of company's profits in their accounts.

Traditional cost-based accounting attaches specific and identifiable financial costs and revenues to inputs and outputs. In the context of corporate purpose, however, cost-based accounting also needs to account for the impacts of a company on financial and non-financial resources. It records the costs that a company incurs in remedying the detriments it causes and delivering the solutions that are associated with fulfilling its purpose.

In particular, to avoid profiting from causing harm to others, a company determines the costs it incurs in remedying the detriments it imposes on human, social and natural resources, and sets these against financial profit in measuring its performance. Conversely, if a company invests in assets that confer benefits on other parties which extend over more than one year, it tracks these outcomes in a way that parallels its treatment of capital expenditure in a conventional balance sheet. In other words, a company's accounting extends beyond financial statements to report costs of maintaining and enhancing human, social and natural resources in the delivery of its purpose, irrespective of whether they fall within or outside the legal boundaries of the firm.

What the proposed accounting framework therefore does is to extend traditional accounting from the legal boundaries of the firm to its effective boundaries in terms of its outcomes and impacts. It redefines boundaries from legal delineations to relevant operational considerations in relation to fulfilling a company's purpose of delivering solutions and avoiding detriments, classifying expenditures in the process as current or capital in nature.

5. A Swedish Example

It may be appropriate to end with a Swedish example in one of the most troublesome sectors globally since the financial crisis and in Sweden since the 1990s, namely banking. Handelsbanken is a Swedish bank that has earned progressively increasing returns for its shareholders from before, during and after the financial crisis.[19] It needed no bailing out during the financial crisis (or the Swedish banking crisis in the 1990s). It is one of the best capitalized banks, with strong solvency and liquidity ratios and a good credit rating. Its purpose is to put the interests of its customers first and to be one of the lowest cost banks of its rivals. It has been successful on both scores for several decades. It is one of the fastest growing banks in the UK and has regularly been rated as the bank with highest levels of customer satisfaction and some of the most loyal customers.

What marks out the bank are three things. The first is its governance. Most banks are run in a hierarchical fashion from the top. That has intensified since the financial crisis resulted in regulators requiring banks to have risk committees that monitor and manage risks from the top. Handelsbanken follows the opposite principle of delegating decision taking down the bank and making branches, and branch managers in particular, responsible for most decisions concerning what products are sold to whom, at what prices and how they are marketed. The degree of delegation is reflected in the mantra of the bank that "the branch is the bank".

The significance of this comes from the ability of branches to establish relations of trust with their customers. They are able to avoid the type of bureaucracy that afflicts more hierarchical banks and to base decisions regarding, for example, loans on more direct relationship-based information. In essence, Handelsbanken has been able to recreate traditional local banking in the context of a large multinational bank. There are important lessons to be learnt from this for how multinational organizations in general can promote local and regional relationships in the context of their global operations.

The way in which Handelsbanken has been able to achieve this comes on to the second distinguishing feature of the bank and that is the way in which it measures and rewards performance. While we are repeatedly told that banks have to pay their staff bonuses if they are to recruit and retain them, Handelsbanken pays its employees no bonuses, at least until they retire at the age of 60, at which stage they have a share in its profit-sharing system, known as Octogonen. It is a very long-term incentive arrangement.

The importance of this is that it promotes the trustworthiness of the bank from the perspective of its customers. Incentive arrangements may help to align the interests of employees with profit and shareholder focused organizations, but they create a misalignment with customers whose interests are not best served by employees who are motivated to sell them the largest volume of financial products possible at the highest profit margins. Instead, what Handelsbanken does is to place emphasis on selecting branch managers, ensure that they are well versed in the principles and values of the bank, and then leave them to run their branches as they see fit. In other words, they put trust in their branch managers who are then in a position to build relations of trust with their customers.

[19] Niels Kroner (2011), *A Blueprint for Better Banking: Svenska Handelsbanken and a Proven Model for More Stable and Profitable Banking,* Petersfield: Harriman House.

The final distinguishing feature of the bank is its ownership. Handelsbanken is listed and actively traded on the Swedish stock market. However, it has two dominant shareholders, anchor block holders: Oktogonen, the bank's own profit-sharing scheme, and Industrivärden, a Swedish holding company, one of whose largest shareholders is Handelsbanken. In other words, it is essentially controlled by a cross-shareholding and the bank owns itself.

The above would be regarded in a conventional context as being one of the worst examples of governance, measurement, incentives and ownership, violating all the standard criteria of good practice. However, it is precisely consistent with the principles of purposeful business described before, and it has been associated with one of Europe's best performing banks over a long period of time. The reason for this seemingly paradoxical result is that there are fundamental deficiencies in the way in which we currently conceive of purpose, profit, governance and measurement.

Superficially, it would seem that a recent decision by Handelsbanken to close many of its branches, in particular in Sweden, runs contrary to its governance model. However, on the contrary, it could be argued to demonstrate the ability of the bank to take decisions at a central level where necessary, in particular to achieve cost savings to fulfil its objective of being one of the lowest cost banks. In so doing, it demonstrates that the board retains responsibility for corporate wide decisions and risks that individual parts of the bank cannot manage on their own.

Furthermore, the reduced reliance on physical branches is a recognition of the fact that a combination of new technology and changing customer preferences between online and in person banking, accelerated by the unwillingness of customers to go to bank branches during Covid19, has allowed Handelsbanken to strengthen its delegated branch approach. It allows the bank to focus local teams on those aspects of banking that benefit from personal interactions with customers, without the need for expensive high street shop fronts or personnel being distracted by more routine transactions that can be handled electronically.

In essence, Handelsbanken is seeking to demonstrate the growing importance of personal relations and local knowledge in the context of big data, artificial intelligence, fintech and the internationalization of banking. The tacit knowledge that comes from personal relations at the local level is a vital complement to the codified information provided by automation and online banking nationally and internationally. It is particularly important in the context of the type of banking in which Handelsbanken excels, namely individual customer, and small and medium sized company relationships. Both benefit considerably from knowledge that only a locally based team of people can acquire from personal interactions with individual and corporate customers over a long period of time.

6. Conclusions

Rolf Skog's has made a major contribution to our understanding of corporate governance. His insights into shareholder governance where shareholders are residual claimants on the firm and the centrality of corporate profits have been profoundly important. Nothing in this article detracts from or contradicts his writings on this subject. On the contrary, the concept of corporate purpose which underpins it, namely profitable solutions for problems of people and planet, merely serves to emphasize that anything other than the realization of corporate profit in the context of solving problems is an illegitimate application of corporate resources.

What has been brought into question is not the significance of profits but what we precisely mean by them in a world in which companies are increasingly dependent and impact on intangible, human, social and natural assets, as well as material and physical assets that lie outside as well as within the legal boundaries of the firm. In that regard, the second part of the concept of purpose described in this paper, namely not profiting at the expense of other parties, is particularly relevant. It throws into question the way in which we both measure profit and incentivize people to pursue it.

That leads to the central issues that have been addressed in this paper about the governance of a corporate purpose which recognizes profit as being derivative of solving, not producing problems, and measurement that needs to account for the costs of rectifying and avoiding producing problems. In this context, governance moves away from a focus on the agency problem of aligning managerial interests with those of their shareholders to one that seeks to promote the identification and implementation of corporate purposes.

The role of the board is then predominantly to oversee the determination of the corporate purpose, ensure that it is the overarching framework within which strategy is formulated, and establish an internal culture, measurement and incentive system that aligns corporate values and metrics with the delivery of purpose. The measurement and incentive systems relate not just to inputs and outputs of the firm in a conventional sense but the outcomes and impacts that they have on those whom the company both affects and depends.

The transition of governance and measurement described in this paper is well underway at both national and international levels with such organizations as the Financial Reporting Council, the European Union, the World Economic Forum and the International Financial Reporting Standards foundation taking the lead. There is much work to be done before a new governance and measurement framework emerges but there is little doubt that we are now witnessing as profound a shift in the corporation as happened in the 1930's with the reporting standards that were put in place by the Securities and Exchange Commission, in the 1960's with the formulation of the Friedman Doctrine, and in the 1990's with the development of corporate governance codes that became adopted around the world.

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