Is capitalism, a rigged game that only benefits societies, halves, executives, and investors, or can companies prioritize both profit and purpose, serve a broader group of stakeholders and solve for the world’s biggest challenges from climate change to income inequality only if you’re truly open to the possibility of being wrong. Can you ever learn? It says today’s guest Alex Edmans. He's professor of finance at London business school and has made it his mission to make capitalism work better. A leading authority on reforming business to serve the common good, his new book is Grow the Pie: How Great Companies Deliver Both Purpose and Profit. I’m Luann Heinen. And this is the Business Group on Health Podcast: conversations with experts on the most relevant health and well-being issues facing employers today. In this episode of the Business Group on Health Podcast, I asked Alex why business needs reforming, how he’d recommend doing that and what makes sense right now, when so many businesses are struggling just to survive.

LuAnn Heinen (01:08):
Alex Edmans. Thank you so much for being here. I’m really delighted to have you talk about your new book, ask you some questions about Grow the Pie: How Great Companies Deliver Both Purpose and Profit.

Alex Edmans (01:20):
Thanks very much, LuAnn. It’s great to be on the podcast

LuAnn Heinen (01:23):
And I kind of hesitate to ask, but how’s the pandemic book tour going?

Alex Edmans (01:28):
It’s actually going quite well, thank you. So when the pandemic happened, I was sad that I had about 15 launch events, all the council, but number one that’s first of all, problems is that there are many people who don’t have jobs at the moment. And for me, just to be worried about a book tour was selfish. And then number two is that I ever been able to do some webinars and like this a podcast. And so what it has enabled me to do is actually reach some audiences that I wouldn't have been able to give physical talks at.

LuAnn Heinen (01:56):
I loved the book. Can we jump right in?

Alex Edmans (02:00):
Absolutely.

Alex Edmans (02:01):
Pieconomics is a new term. Can tell us about what it means?

Alex Edmans (02:06):
Yeah. So the traditional view of a business is that the value that a company creates is given by a pie and the size of the pie is fixed. So if you're a CEO and you want to make more profits, i.e. you want to take more of the slice of the pie for yourself, the only way you can do that is by reducing the slices of the pie.
Given to other people, maybe through paying your work is less or paying less tax. But what the book is about is the idea that the pie is not fixed is that the best way to generate profits is to grow the pie. So to generate value for society, for example, or through motivating and inspiring and leading your workforce, by paying them more, you’re not necessarily donating money to them. You’re actually making them more motivated and more productive. And then as a byproduct, your profits go up so you don’t seek to target profits directly. Instead, you see your profits as being a byproduct of serving wider society.

LuAnn Heinen (03:06):
So, you know, the famous economist, Milton Friedman is known for writing that the social responsibility of business is to increase its profits, but you’re making the case for creating social value. Can you say more about that?

Alex Edmans (03:20):
Yeah, that's right. And actually one thing is important to stress is that Nelson treatment is not a million miles away from what I'm arguing. So anybody who wants to characterize your business and sell a load of books will say, I'll look up Milton Friedman's quotes about increasing profits. That just shows how evil capitalism is, I'm going to propose a new way of doing capitalism and that's going to be much better, but actually that's, I think an unfair caricature of Friedman. So what he said was a company should only focus on profits because at least in the long run, the only way that you can deliver profits is through, by taking stakeholders seriously, by investing in your employees, by not polluting the environment and not choosing on taxes. So contrary to popular belief actually Milton Friedman does advocate taking stakeholders very seriously, but I'm still argue that I go beyond this for one main reason, Milton Friedman would argue: you should invest in stakeholders if you can count collate the benefit of doing so in terms of profits. Now it's easy to calculate the benefits of investments such as building a factory, because you can forecast how many widgets and how much money you will get from selling them. But how much money will you make through treating your workers better through giving them more maternity leave or paternity leave? You can't calculate that. So my idea of starting with social value first, and then seeing profit as a byproduct of fat, that is freeing because it recognizes that you can't reduce everything to a mathematical calculation, because if you try to use this tabulation approach, then many good investments would not be made just because you wouldn't be able to forecast the benefits of those investments.

LuAnn Heinen (05:08):
So when you you've said, you've written that profits are an outcome, not a goal. And can you talk some more about how that comes into play with the current interest in purpose driven companies and brands?

Alex Edmans (05:20):
Yeah, absolutely. So often when people think about purpose, they think about corporate social responsibility. They think about this being an optional, extra something ancillary to be delegated to a CSR department. But if indeed profits are an outcome of purpose, this is a CEO level issue. What this means is the primary way in which a company should try to make money is through serving society, be this to making products that transform customers’ lives for the better, providing employees with a healthy workplace or stewarding environment for future generations. Now the skeptical and discerning listener might say, well, isn't it just wishful thinking to think that if a company serves society, it will become more profitable. But actually the book is backed up by a lot of rigorous hard evidence showing
that this is not wishful thinking, actually, companies that deliver more value to stakeholders also deliver more profit to investors as a buyer.

LuAnn Heinen (06:23):
I love that a statement you made that a purpose is more than a mission statement. And some of the company examples in your book are business group members, companies like Costco and CVS Health. Can you talk a little bit about how purpose plays out?

Alex Edmans (06:36):
Absolutely. So again, it's what is the end goal? So under Friedman, profit is the end goal and serving stakeholders. You need to do that, but that's a means to an end, whereas with CVS and with Costco, the end goal is to serve wider society. And I can give a specific example, for example, a CVS. They decided to stop selling cigarettes, even though they were generating $2 billion of revenue. So no calculation would have ever justified stopping to sell cigarettes. But the CEO, Larry Merlo said, we're going to stop that because we have just renamed ourselves CVS Health, I don't want this just to be a name change, I want this to pervade what we do and selling cigarettes. Is it consistent with our purpose, which is to put people on their path to better health. Now, as a byproduct, it turns out that CVS has become very successful. It may well be because the customers have bought other things other than cigarettes, but they can never forecast that outcome. And so that's why a purpose driven company would have made the decision to stop selling cigarettes, but a long term profit driven company would not have done so.

LuAnn Heinen (07:48):
And you know, you've made the case that it's urgent for business to recognize it, that quote "its responsibility to society is arguably greater today than ever before". And why is that?

Alex Edmans (08:02):
Yeah, I think it's because there's a concern that capitalism is only benefiting the elites and not why does society? So what have you seen happen over the past couple of decades? You've seen profits go up, CEO pay go up, whereas incomes are stagnant. And I guess it's something is going up for what is society, if the is going up, but that's obviously something which is negative. So that's one, one reason is that the concern that capitalism is not serving wider society. And therefore, if businesses don't recognize this, there can be heavy regulation and a tear up of the current capitalist system. And that's indeed something that policy makers have proposed. But the second reason is just the scale of social problems that we have. So even before the crisis there's climate change, automation, population growth, resource usage, and there's the concern companies were either happily making money, ignoring those social problems, or even contributing to those social problems.

Alex Edmans (09:02):
And now with the coronavirus crisis, there's now an even bigger social problem. So it shouldn't be that if you're like Ford, you should keep making cars. Instead, what they've tried to do is to use their air bag material to make masks. Similarly, if you're a perfume company, you can't just happen to keep making perfume instead. Well, let's use your expertise in alcohol to make sanitize with steps. So here there's responsibility for companies to address this massive pandemic that we have, because if they don't like, and then we're in even more prolonged economic recession, then nobody will be buying perfumes because people won't be able to afford to do that.
LuAnn Heinen (09:40):
And also during COVID, we’ve seen Medtronic share its patents and processes on ventilator, manufacturing and GAP prioritize, making face masks over fashion, and J&J invest in bringing vaccines to market, on a not-for-profit basis. So, but is there any evidence that purposeful organizations do better in these uncertain volatile times?

Alex Edmans (10:02):
Yeah. So the study that I did never try was delighted to present it to Business Group on Health a couple of years ago, looks at the link between treating your employees well and longterm stock returns. And luckily I had 28 years of data to do that. And that was really important because many measures of purpose are only available, let’s say for the last 10 years, because the purpose is quite new. And the last 10 years have all been up years. And so even though I found the positive relationships, you might think, well, purpose only pays off in good times and bad times, that’s when we really need the money and we need to scale back on it. But in those 28 years, I had both recessions and booms and I found that the results were strong in both types of economic conditions. And interestingly, there’s a paper by one of my colleagues at London Business School, which looks at a measure of purpose, not just for employees, but all stakeholders as well. And he finds that in normal times, this doesn’t pay off, but in downtimes it does pay off. And so their interpretation is that when we’re in a downturn, that’s when an employee and customer trust is most important. And that’s where companies which have high trust customers will stay with them, even during a downturn.

LuAnn Heinen (11:28):
You know, in a downturn in particular, there’s concern about growing income inequality in this country, why wouldn't reducing executive compensation help other stakeholders? There’s an example in your book where you discuss how it's, you know, not as, not as helpful as it might seem at first blush.

Alex Edmans (11:45):
Yeah, absolutely. And I think this is one of the important roles of evidence. And so what I’m trying to do is go after the same, that many others are, which is trying to solve social problems. But actually when you look at the evidence, then the optimal solution might be different from what many people are offering. So the traditional view is that what if we want to make things better off for rank and file employees, then just pay the CEO less and then redistribute her pay to everybody else. But that’s based on the idea of pie splitting- is that the value that a company creates is a fixed pie. So the only way to make workers better off is to take from the CEO. But evidence shows that the pie can be grown. So the better way to reform pay is to give the CEO long term incentives.

Alex Edmans (12:37):
So if she knows that she’s given shares, she can’t sell their shares for five years, then she knows that the way to improves the value of the company in five years, time is not through cutting wages or failing to innovate and going off short and profit. She knows that she needs to invest in her work is really seriously. And indeed there’s evidence that shows that when CEOs are given long term pay, then they will grow the pie, create the value for wider society. The companies become more innovative and also the treatment of employees improves. So again, ensure what this means is to make work as bad off. Don't try to cut the senior pay and distribute it- instead if the CEO has longterm shares, I eat a slice in the pie. She knows that she’s going to having incentives to grow the pie. And by doing that, she's also going to create more value for rank and file employees.
You know, your book, you gave another example in your book of a current and telling example of how policies or perhaps politics that would seem to protect public interest actually may not. So remind us what happened when Amazon chose a New York City location for its new East Coast headquarters.

Yeah. Thanks for doing that. That's really important because that shows the importance of having the pie growing rather than pie splitting mentality. So this was Amazon thinking about whether to have a location in Queens, New York City, and they were being offered three billion dollars of tax breaks. And there was opposition to that mainly led by Alexandria Ocasio-Cortez arguing: well, why should we give this massively which company $3 billion? And I can understand that on the face of that, that seems outrageous. But notice that fat three billion was not given as I'm donating a slice of the pie to Amazon instead. What was, what their deal was was that if Amazon came to Queens, it would have created tons of value. It would have created 25 to 40,000 jobs with an average salary of $150,000. It would have created $27.5 billion of tax revenues.

And so that would have just been a byproduct of growing the pie. It wasn't just a donation at the expense of Queens, like Queens would have benefited from all of these jobs and all of these tax revenues and Alexandria, Ocasio-Cortez said at the end today was the day of week of dedicated everyday New Yorkers. And they defeated Amazon's corporate greed. They held it as a victory. They thought, okay, we're making Amazon lose. Therefore we're going to win, but everybody lost—like the pie shrunk because Amazon did not move to Queens. And it lost even more tax revenue, 27.5 billion of tax revenue than the 3 billion of tax rates that are being offered.

Oh, well the state of Virginia benefited from that.

Yes. And so this is why maybe they have the pie mentality. And so while it may be that there was some tax incentives for Amazon to locate there, they're still overall paid substantial amounts of tax. So the state is still benefiting even though maybe they would have benefited even more without that in tax incentive, but it's better to get substantial tax revenues than to get nothing at all.

So another company that's featured another, a very successful tech company, that's featured a little bit in the book is Apple. Can you talk a little bit about some of the Apple related headlines that we read in the paper?

Yeah. So I think one interesting thing is to look at what they've done in the crisis. They have partnered with perhaps their biggest rival, Google in launching contact tracing systems, which are usable for both iPhone and Android. I think that's really important because if we think about responsible business, often people think about responsibility as splitting the pie differently. So we're going to donate profits to some charity. We're going to pay more tax. We're going to pay workers higher wages. And so that's
where we're reducing the slice of the pie, which goes to investors, we're going to increase the slice that goes to everybody else and don't get me wrong. Right? So splitting the pie fairly is absolutely part of responsibility. Companies need to pay fair taxes and fair wages. But what I'm saying is companies must go beyond that and grow the pie through engaging in innovation.

Alex Edmans (17:19):

And so this is something that Apple is doing by launching the contact tracing system. So what would it be the media backlash if Apple had not thought of this idea? Probably very little, it's not as high as the backlash for not paying taxes or mistreating your workers. But I think what they're doing with launching this contact tracing system is as massive in terms of just the innovation it provides and the value to society. I just, I think yesterday I've updated my phone for the new iOS app. And actually what they've done is that they've made that the phone worked better for face masks. People are using their face masks and they can't use face ID. It makes the number screen easier to appear. And that's important because if indeed they need to take their face mask off in order to get Face ID, it could be that more people get sick. And so what we think about responsible business should not only be about, do no harm, don't cheat on taxes, don't mistreat your workers, but actively do good for innovation. And I think that's something which has provided Apple. I give many examples of innovation in the book. The book was finished before coronavirus, but even after coronavirus, they're still continuing to innovate.

LuAnn Heinen (18:28):

Yeah. That's a great example. What, for companies who are interested in growing the pie by focusing on creating value for employees, where should they start?

Alex Edmans (18:38):

I think a good place to start is to think about what the company's purpose is. So purpose is often a misunderstood word, so people often think a purposeful company is an altruistic company, but that's actually not the word what the word purposeful means because like a purposeful meeting is a meeting with a clear objective and agenda. If I do something on purpose, I'm doing it deliberately. And so simply for a company to think about what its purpose is, it shouldn't be to create value for customers, employees, shareholders, suppliers, taxpayers, and the environment. You can't be all things to all people. It should be focused on particular. As I mentioned, for example, it may be that you're a bank and you might think, okay, climate change is the word of the day. But actually as a bank, the main way in which I'm going to create fund is not so much by reducing my carbon footprint, but providing financial inclusion to people, being fair with my marketing and advertising.

Alex Edmans (19:40):

And indeed, if you look at how some banks responded to the crisis in terms of showing full bounds with loans, that's indeed what they've done. So I think to focus on where you think you can add most value, I would define purpose as the answer to the question, "how is the world a better place by my company being here?" And the answer to that must be focused. Like if a citizen was to answer that question, they couldn't say, Oh, the world's a better place because I'm going to be a doctor and a lawyer and an entrepreneur and a teacher, you choose one of those things and similarly for a company you should be focused. The second thing I think it's important to do is just to change the mindset because often people think about a fixed pie. So the only way I can increase my profits is through treating workers less well or by cutting on my environmental initiatives. But again, what the evidence suggests is that many things
that serve wider society ultimately benefit companies, even if you could have never predicted those benefits from the outset.

LuAnn Heinen (20:40):
So picking up on that, how do health benefits and well-being programs play a role in delivering both profit and purpose? Do you have an example?

Alex Edmans (20:49):
Yeah, I think they play a massive role. So again, it's stopped. We thought of employees as being a cost to be minimized: the less that you can pay out your workers, the more profit you can make. And arguably the most famous management innovation of the 20th century was the assembly line. So Ford invented that because it forced workers to keep up with the pace of productions that squeeze every ounce of effort away from them. But actually that's not true. And the evidence that I mentioned earlier over 28 years of data shows that companies that treat their work as well indeed do better in the long term. So I'm just one company I happen to know because I interviewed them for the book was UBS. You have this health matters initiative. And I industry such as investment banking where there's so much stress, there's so much pressure to be always on.

Alex Edmans (21:43):
They said, no, we're going to take really seriously. People's physical health and mental well-being. And I know that companies are responding to that in the current crisis. There are some companies which are could do to pay workers who were furloughed. Other companies can't afford to keep paying workers, but they'll at least maintain their health care benefits. Others recognize that their employees are having to work from home. And then there's mental health issues with isolation. And they're trying to ensure that to work as has support schemes for that. Again, these are the idea behind this is to view workers as partners of the company, rather than just inputs into as if, as the factual production.

LuAnn Heinen (22:25):
That's terrific. Well as discussed, you know, your book came out near the start of this COVID crisis some few weeks ago. And today the death toll globally is over 350,000 lives with still no cure, no vaccine. What thoughts, anything encouraging particularly, could you offer from a global economic perspective?

Alex Edmans (22:45):
Yeah. Thanks LuAnn. So clearly the crisis has been really devastating. I mentioned, I think there could be two silver linings from that. The first is it has changed the idea of responsibility from pie splitting to pie growing. So there are many companies, who, in the crisis, they cannot act responsibly by giving parts of the pie up, just because they just don't have profits to get. But instead, what they're doing is they're innovating and that the way that they're contributing towards wider society. So you could be LVMH that perfume manufacturer, you might think I've got nothing that I can usefully give, donating perfumes is not going to help now, but they say no, well, let's try to be innovative. And we reprogram our perfume factories to make sanitizing steps. If we think about enough, about responsibility as innovating and actively doing good, rather than just not doing bad, I think that's something that should permanently stay with us.
And the second is going back to employees, as you just mentioned. Now, what we recognize is that employees can work from home. They can be trusted. It's not that they need to be monitored by a manager, eight hours a day. Maybe we realize that we don't need as much business travel because we can do a lot of meetings quite effectively by Zoom. And not only is that good for the environment, it might also be good for gender equality, because that might mean that working mothers are not pressured so much to be on the road the entire time. And that has further beneficial impacts on diversity. So if indeed, we now realize is that flexible working time, the use of communication technology, such as Zoom, work from home, I’m going to be much more acceptable. I think that could be a silver lining to what has otherwise been a devastating,

LuAnn Heinen (24:37):
So hope for the future of work, hope for capitalism, hope for our planet. That's a great way to end. Thank you so much, Alex, for being here with us today and sharing your insights.

Alex Edmans (24:47):
Thanks very much.

Speaker 3 (24:51):
I’ve been speaking with Alex Edmonds author of the new book, Grow the Pie: How Great Companies Deliver Both Purpose and Profit, about how capitalism can serve all stakeholders through creating value and avoiding a pie splitting mindset that's focused on profit alone. I’m Luann Heinen. And this is the Business Group on Health Podcast: conversations with experts on the most relevant health and well-being issues facing employers today.