23 Things We're Telling You About Capitalism II [1]

Written by **Tim Worstall** [2] | Wednesday 8 May 2013

In his second chapter Chang tells us that companies really shouldn't be run in the interests of their shareholders. All this guff about shareholder value is just that, guff. Precisely because shareholders can just cut and run by selling their stock they are in fact the most short term thinkers in the entire system.

An argument for which a case can be made and Chang tried to make it. Unfortunately this doesn't really accord with that real world out there: who actually does, no not in theory, but who actually does have a longer term view than the shareholders? Certainly not politicians as they never look beyond the task of winning the next election. And it would be difficult to accuse British unions of thinking much beyond the next pay negotiation. I might even be true that shareholders don't think enough about the longer term: but there ain't nobody else out there with a longer time horizon than the shareholders have. After all, the current value of the shares is the net discounted value of all future income from them. Any company that really isn't thinking about the long term is therefore going to have a low share price.

But there's a much larger underlying confusion in Chang's thinking here. He talks about other ways of organising matters so that extant companies do indeed exist long into the future: deliberately having strategic stockholders for example, the way that the Japanese keiretsu do perhaps. The problem with this is that there's no particular reason why a specific company should exist for the long term. Indeed, it's often entirely desirable that they do not, that they go bust and the assets then distributed in bankruptcy to those who can make better use of them.

Most growth in the economy, and almost all employment growth, comes from new entrants into the market. It is small firms starting and growing, old firms failing and leaving, which changes the marketplace. Yes, of course, we can all think of examples of the opposite: I can never remember whether it is Ericsson or Nokia that started out making gumboots and switched to mobile phones. But this is very much the exception. It is the start ups that revolutionise the economy to all of our great benefit.

Once we accept that then the very idea of trying to insist upon the long term viability of a specific company becomes a nonsense. We want to be able to increase and grow the economy into the future, yes we most certainly do. But there's no particular reason why the corporate entity called Rover, or Rolls Royce, or Glencore, should survive log term. Indeed, there's good reason why we'd be quite happy for firms to die out at some point. That point being when their particular skills and advantages are no long appropriate to the demands of the rest of us in the economy.

Schumpeter made this point, that capitalism is all about creative destruction. Those small companies do provide the creativity and it is the end of large companies, at the end of their business or technological tether, that get destroyed. Stakeholder interests make that destruction a great deal more difficult. Two recent examples:

Uber is a method of hailing a yellow cab over a smartphone rather than waving your arms on a street corner. This isn't rocket science. But it has taken a year so far to fight through the bureaucracy to get this simple system licensed. And once that had been achieved the "stakeholders", the limo drivers of New York

City, sued to over turn that. On the grounds, incredibly, that it would be age discrimination as older people were less likely to have a smartphone. Or, as we might put it, the incumbent stakeholders were resisting their creative destruction.

The blast furnaces at Florange in France are another example. The unions, and then the government acting on the behalf of such stakeholders, are insisting that these blast furnaces must remain open. Except no one at all wants the iron made in these furnaces. Technology has moved on, we now recycle a lot of our iron and steel here in Europe. To the point that we just don't need as many blast furnaces as we did: they've been replaced by electric arc furnaces. So who is doing better for the economy as a whole here? The stakeholders fighting to save the past or the shareholders liquidating that past? I would certinaly argue that the shareholders here have the longer term interests right.

And that's what becomes problematic about that stakeholder, as opposed to shareholder, economy. It becomes static. If the stakeholders, as they will, demand that their interests be protected then the interests of stakeholders will indeed be protected. Which means that we cannot have enough of that capitalist destruction to make room for the new capitalist creation. I'd be willing to accept the stakeholder argument if we did in fact desire a stagnant economy. As we don't, I don't.

Another way of putting this is that by running companies for the benefit of the wider community, rather than purely for the profit of the shareholders, we entrench the power over what that company does, whether it survives, whether it gains entry to government subsidy schemes perhaps, in that wider community of stakeholders. Who will, as Adam Smith didn't quite say, then conspire against the wider public to ensure the continuation of their benefits from their stakeholding interest. Which isn't what we want at all. We want companies to continue as long as they continue to make a profit: for profit is that signal that the output is worth more than the inputs, that value is being added. Once that is no longer true we want the companies to fold and make way for new market entrants. Given that profit is the marker of this success or not then we want these decisions made by those who benefit from the profits: the shareholders. Not by those who benefit from the jobs, or patronage, or political power: so not by the workers, not by the unions and not by the politicians.

If stakeholders get to run the system then we'll still have blast furnaces 50 years after they're technologically obsolete and we'll all still have to stand in the rain to get a cab. For stakeholder interests gum up that creative destruction that is the very essence of capitalism.

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