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Corporate Political Responsibility Taskforce

Expert Dialogue with Karthik Ramanna

Karthik Ramanna - Module #2

Elizabeth Doty: Thank you for joining us today. My name is Elizabeth Doty, I'm the director of the Corporate Political Responsibility Task Force at the Erb Institute at University of Michigan, and I'm delighted to be moderating today's conversation with Oxford Professor Karthik Ramana.

The Corporate Political Responsibility Task Force, or CPRT, is an initiative of the Erb Institute, a 25 year long partnership. Between the Ross School of Business and the School for Environment and Sustainability at the University of Michigan. Led by Managing Director Terry Nelodov and Faculty Director Tom Lyon, the Erb Institute is known for its leadership in three areas, [03:53:00] teaching and learning, business engagement with groups like the CPRT, and scholarly and applied research.

The CPRT's mission is to help companies better align their approach to political influence with their commitments to purpose and values, sustainability, and stakeholders. As we're seeing, corporate political responsibility is an increasingly pivotal element in managing stakeholder trust, addressing systemic issues, and rebuilding public trust in institutions.

I'm very excited to have someone who's thought so deeply about this. Professor Ramanna or Karthik, if you don't mind as we, as we do in the seminar style conversations really has the perfect background for this conversation. I know this will just be the start of something I hope will continue as the task force does its work.

He is a professor of business and public policy at the Blavatnik School of Government at University of Oxford. It's a new school. He's an expert on business government relations. Sustainable capitalism, corporate reporting and [03:54:00] auditing he has studied how organizations build trust with stakeholders and the role of business in designing sensible and responsible rules of the game.

And that's going to be really important in our conversation today. He directs their Master of Public Policy program, a new program, a flagship for current and prospective leaders in government. And I suspect not just in the UK. He has taught leadership, corporate governance, and accounting at Harvard Business School, consulted to companies leading organizations like Fidelity, KPMG, McKinsey, Pricewaterhouse and State Street, dozens of research articles, case studies, numerous awards, and serves on the editorial boards of several scientific journals.

And I just learned that his book was endorsed by both Elizabeth Warren and Charles Koch. So we're going to have an interesting perspective today, I think more foundational rather than picking a side, right? So that's going to be fantastic. Karthik, thank you for joining us today.[03:55:00]

Thank you. Now we move from this idea of Business being called in to solve the effects of these trends around globalization, around short termism and markets, I think that comes from some of what you described around inability to deal with externalities around climate, things like that. So now let's shift, let's make, you go to this proposition in the article that if we encourage companies to step in further in an interventionist role, to step into the void of what government hasn't been able to do.

We will not only not solve it, but we will further depreciate the public institutions and trust in them. And, and instead you propose an alternate focus for reform, I think from inside and outside. So could you start with just what dangers you see to civil society briefly, if business were just to follow this impulse to help by stepping into the void.

And then tell us why you think there's a better focus that you use the idea of a moratorium on. The rules of the game. Can you [03:56:00] cover both of those in one part?

Karthik Ramanna: Sure. So, so there are three reasons why I'm skeptical of this sort of you know, the fashion in business school seems to be sort of, you know, corporate social purpose and and then, of course, it's called different things and by different authors, but it's this idea that here will business as a sort of white knight and you know, show up in shining armor and, and, and save us from, from sort of all of these ills that we face.

And, and, and the first is the first reason I'm skeptical is the evidence just isn't there. I mean, you know, look, if we're talking about. The so called win wins which many sort of business school gurus like to focus on. I quite frankly see that as a red herring because no business needs a business school guru to tell them here's a win win you need to go chase after it.

Business has a nose for making money. And if they see a win-win, they're going to go do it anyway. They don't need some academic to tell them this is, Oh, look at these win wins, go chase after them. They're going to do it anyway. The, the, the issues that we [03:57:00] really worry about are the win loses. That's what I'm focused on.

And that's where, so. And, and the evidence in those cases is just not there. I mean, the, the idea that, you know, business will do the right thing when no one is looking, that's the whole point of thin political markets. They don't, I mean, I just don't see that happening systematically. This is not to say that there isn't any business that has ever done anything.

Obviously not. That's, I mean, that's not the claim I'm making. I'm saying I wouldn't build in public policy on the hope and prayer. That business will do the right thing when no one is looking. I think that would be a profoundly stupid thing to do. So that's the first reason the evidence isn't there. The second is this notion of ideological capture which is that you know, we are so lucky that corporate engagement in the political sphere has been restricted to profit.

Imagine what a horrible world we would be in if, in addition to pursuing profit, these corporations also wanted to [03:58:00] use their voice to tell us what to do on abortion, or what to do on when to wear hijabs, or what to do on gun rights, or what to do on, right? I mean, I certainly don't want Mark Zuckerberg telling me what to do on all of these things though apparently he might be telling us in different ways, but, but that's a different point.

But that, that the idea that corporate political engagement has been destructive we are lucky that it has been destructive only insofar as the realm that business did it I would be much more scared of a world where You know, this then became about the CEO's own ideological wins. And of course, people point to again, Germany, and they say, but look at Germany and see how well it works there and this and that.

And I say, well, you know, to an extent, that's true. But Germany is a much more homogeneous society and those northern European countries are much more homogeneous. And in fact, they don't do a very good job of integrating minority

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perspectives for that reason. [03:59:00] So we're definitely a much more by we, I mean, the United States in this case now are much more heterogeneous society, but also this is the case with the Anglosphere world.

So the UK, Canada, Australia, et cetera. So I just don't see that model working. And the third is. is this idea that of separation of powers, you know, the, the, the single most compelling innovation in, in, in government in the structure of government in the last two, 300 years has been separation of powers.

And, and if you told me that Oh, the legislative branch is failing. So why don't we put the judiciary in charge of it? I mean, you know, I mean, that would just be a really, really sort of awkward way to solve the problem. So yes, business has done a fabulous job making money over the last 40 years while governments and civil society have failed.

But the solution to that is not then to put business in charge of the role of government and of civil society. That would be really dangerous. This is where separation of powers come in. And just [04:00:00] like you separate, The roles of the executive, the legislature and the judiciary, you separate the role of business, civil society and government and and the solution to the failure of one or two of those institutions is not the third one in charge.

So that's where I sort of start with this, this notion of why I'm really skeptical of it. And, and then in terms of what to do, I'd say, well, quite frankly, this idea that of corporate political speech is a social construct as, as we go back to the Powell memorandum and we go back to, right. It is not something that is somehow inalienable in, in, in sort of us constitutional canon or something.

It's as recent as, as 40 years, that's all. And, and it is. You know, so, for instance, something as simple as the Treasury saying, well if you want a tax deduction on debt, then and you're a, you're, you're sort of a for profit corporation, then you can't engage in political speech. Right. I mean, that, that doesn't require an act of Congress, it doesn't require constitutional sort of change or [04:01:00] anything like that.

That's something simply can be done by Treasury ruling. And, and there is ample precedent for that because, of course, Treasury rulings to that effect for 501 C3 is already exists. So I'm saying you can just do that for for profit corporations too. So that's, that's just sort of a quick, quick and easy way to sort of say you could introduce this moratorium.

The final point I'll make in this is I make a distinction between the role of business in the political sphere and the role of business individuals or business leaders. Now, while constitutionally we can have, I think, a very legitimate challenge to the idea that businesses have you know, unfettered political speech rights, that doesn't of course exist to extend to business leaders because business leaders are citizens.

They're, they're human persons, not corporate persons. And, and, and so, There is actually a legitimate conversation for the role of managers as individuals in this process. And, and, you know, you go back to [04:02:00] notions of, say Greek heroes like Cincinnati and and, and the idea that, that, that, that you would have someone who at different stages in their career are called to you know, serve different purposes.

No civilization in history has survived for any meaningful period. If at least some of it's especially endowed elite do not use that privilege for the sake of the whole rather than for themselves. And so you cannot imagine any society in which. The privilege do not surrender some of that talent to the public good.

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That is not something that we can escape and we do need managers, because they are in positions of great privilege to act as individual citizens to do the right thing. I just think that it is sheer folly to imagine that you can build public policy around this sort of Pollyannish vision that that businesses will somehow systematically do that all the time, or most of them. [04:03:00]

Elizabeth Doty: I want to go into this distinction about who can do what? But I want to dive into you. You went past it. I alluded to this idea of a moratorium on setting rules of the game.

And I love that you're focusing on the rules for setting the rules. Right, like the Treasury ruling you described is setting the parameters under which business can influence the rules by which markets work right or business and the economy works. But you also have just had a piece in HBR accounting for climate change.

And you've mentioned several times supporting sensible and responsible rules for the economy. We haven't even gone into all the places that that matters besides accounting rules and globalization rules. So the question is, and you also define this idea of pro social rules. Can you just describe and bear with me on this?

Because we have people within business who are worried [04:04:00] About the state of trust in civil society, about the ability of the economy to generate opportunity, and about belief in capitalism so there are people in businesses in their roles, who are seeing business impacts from this who therefore have some So, can you spend a little more time on what the ask would be.

Around how business affects the rules, this idea of pro-social rules, whatever it is, like you need to spend a little more time on that. Then we'll come back to Libba and the question of reform in these different capacities.

Karthik Ramanna: Just to clarify, by business there, you mean business as a corporate entity as opposed to business individuals?

Elizabeth Doty: I do. I do. And I think because there are impacts right now on employee engagement, retention, brand, et cetera, there are. economic arguments for cleaning up how you influence politically.

Karthik Ramanna: Absolutely. And I think those are those, the win-wins that I talk about, right? That, that look, when those win-wins exist there.

So for instance you mentioned the accounting for climate change articles. So this is a piece that it's a fairly [04:05:00] technical piece in HBR, which is my co author, Bob Kaplan and I have effectively Drawn on 50 years of best practice and financial accounting and cost accounting and built what a carbon accounting system could look like, which basically runs on the existing infrastructure of the financial accounting system.

So it would not take trillions of dollars to run this carbon accounting system. involve adding a few line items in a QuickBooks software or in a ERP system. So that's, you know, that's how, I mean, we, we say, look, this is the cleanest, simplest way to solve sort of the, the issue of holding corporations accountable for GHG impact.

And then we sort of go into the technical details and that's in this, this last week's edition of HBR. run through December. You can find it online. And, and, and, you know, when we came up with that article, of course as characteristic there were some people who absolutely, businesses who absolutely were all over it and loved it.

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And some who saw it as a threat. So for instance SAP, which is the world's largest ERP system. They love it because [04:06:00] of course it's a win-win for them. They will make the ERP systems that for them. This is great. This is more business. So SAP immediately called up and said, we'd like to do something with you on this.

This is great. I could use the whole power of SAP. To get this thing through. That's that's a win-win. That's that's why I said these these companies don't need some business school guru telling them to seek win-wins. They read the article and they called me 30 seconds later saying we want to work with you to do this.

So that's at the same time. What we say is that look, this whole asset management industry sub industry that exists around so-called sin stocks and green stocks, et cetera. That's just bogus. The idea that, you know, you have sin stocks and green stocks imagines that, for instance, there's no fossil fuel content in your iPhone, or there's no fossil fuel and content in this thermos, right?

The idea that we can exist in a capital market economy with a sort of broad based portfolio that is devoid of fossil fuels is absurd because the fossil fuel industry [04:07:00] would not exist at its scale and scope. The mining industry would not exist at its scale and scope if it weren't for the fact that it was adding enormous value in the consumer economy.

So when we talk about a system, an accounting system for carbon, we're saying we need to level up the fact that it's not just the fossil fuel people who are accountable for this. It's the Apples of the world that are accountable for it. It's the Thermos makers of the world who are accountable for it, et cetera.

They're all using some element of carbon in it. And, and let's, let's have, so basically the output of our accounting system is sort of like when you go to a grocery store and pick a cereal box, you've got the price. And then you've got the nutrition information. We say every product and service in the economy can have a price and it can have a what we call an E liability, which is the CO_2 equivalent of, or CH_4 or N_2O or whatever it might be of that particular product and service.

And by the way, you can do this at fairly minimal cost because the existing accounting system is designed to produce [04:08:00] those kinds of numbers. So the people who are very nervous by this is that entire asset management sub industry that sell these so called, you know, sin stock free portfolios, et cetera, which by the way is, is, is just such, I mean, I sit on the investment committee of one of the largest endowments here in the UK and we get routinely pitched with this nonsense.

And when you ask them, well, how do you measure these things? Oh, we just don't invest in the fossil fuel companies. Well, I mean, from the perspective of an endowment that's running a charitable institution, well, fossil fuel usage is going to go up in the next decade. And I've got to think about, you know, I can't just simply invest in companies that are not fossil fuel companies because all these other companies are going to be using those fossil fuels.

So, I could imagine that there will be a lot of people that will be very upset with this kind of accounting system and they will lobby vociferously and as we've talked to regulators about the regulators are interested in this God bless them. But as we've talked to them, one of the things that they've been very candid with is how will the finance industry respond [04:09:00] to this and will they be behind it and I said well not every one of them will, and this is where you've got to show your courage and say you know what, we're going to do it notwithstanding.

So it's that those are the situations where there will be winners and there will be losers from good data.

Elizabeth Doty: I'm right with you on this and we are actually talking to some companies that are worried about appearing to be self-interested in supporting regulations that would level the playing field right because they do get, they do have a win win aspect.

That we're hearing also there's an enlightened self-interest middle ground in there that says take away our weapons as long as you take away every else's weapons. We see the writing on the wall we need to support this and we've seen that in prior eras, where say railroads asked to be regulated because it would reduce the rivalry that was destroying their business, you could see that in.

If you were seriously concerned about climate, you might say, look, we won't do [04:10:00] any political spending. And we'll let this play out in the public sphere. And we've seen companies like IBM refuse to do political spending and get lots of brand recognition for it, even though you could argue it limits their ability to pursue their interests.

You just, you're skeptical of that. Yeah. Well, I mean, IBM hires a lot of folks coming out of the Pentagon, so I think they do their political lobbying and their, their, their political speech a different way. So, you know, that, yeah, so I'm, I'm no, but, but there is a category there, right?

Karthik Ramanna: Yeah. But I mean, look, quite frankly, I'm not holding my breath. I'm not saying that there aren't companies that aren't that don't want to do the right thing. Of course, there are. I just don't think we can build public policy on that. Quite frankly, you know, now in the last two weeks, we've heard so much about the so called net zero.

That is the most empty statement there is because anyone can say anything is net zero. There is no accounting for what is net zero. There is not a single accounting standard and there is no way to verify or audit. any claim that something is net zero. [04:11:00] So I can come out and say just now on this call, I am net zero and you cannot audit me.

You cannot verify what I'm saying. I can just make that up. So in the same sense that, you know so when companies say that, I mean, I'll smile and not, I'll be really polite, but I'm not holding my breath that they're going to change the world about it. And if you want to change the world, you need really hard, measurable things that you can, when they don't do it, you can take them to court and say, This is what you said you would do.

This is the objective number that you reported. This is how it was audited. You didn't do it. I'm taking you to court. That's that that's that's the way you you get these things done.

Elizabeth Doty: Thank you. Can I turn now to you, Libba. You had a response to the conversation about changing the rules.

Guest: Well, I love your reference your creative irreverence and the broad scope of it.

And, you know, in sustainability, the. Most creative, innovative thinking is coming out the sustainable accounting people for, you know, [04:12:00] because those are the rules, any event. I, so I'm, I'm highlighting your distinction between managers and institutions and pointing to the trend in The start in the 90s of the managers being rewarded in stocks, right, which changed the rules of the game, or at least the separation.

Let's just talk about the separation of power, you know, between the people in the institution and and the institution and then and then how the stock buyback craze now, can you speak to that a little bit in terms of, you know, your theoretical perspective?

Karthik Ramanna: Yeah, sure. So the accounting rules right now make it really quite simple to if, I mean, this is much of what, not much, but half, I'd say, roughly of what happens in private equity where you know, these companies are loaded up with a lot of debt.

They expand and expand, Tremendously the [04:13:00] companies the, the, the equity owners, the private equity owners are able to pay themselves out enormous dividends in the process. Those dividends could be cash dividends. They could be buybacks, whatever it might be, whatever form it takes. And then the company has left a shell of what it was.

And this, the, the, the employees are obviously out of a job that the customers don't get the value that they had sought, et cetera. So, for instance, the. Let me give you a very concrete example of this. The largest one, one of the largest, not the largest public service outsourcers here in the UK is a company called Carillion.

And you know, in, in 2010, when David Cameron and George Osborne, you know, came to the, the Prime Minister and Chancellor role here in this country. They went on this, like, Massive outsourcing thing where, you know, Oh, everything is done better in the private sector than in the government sector. So let's outsource everything.

So they were, they outsource a lot of public services. And a lot of these companies grew like Carillion that they got really big and they got really, and they were out there. [04:14:00] You know, sort of bidding really competitively against each other in order to win these contracts. Now, it turns out that they bid at prices in which they just couldn't deliver the underlying service.

So, you know, imagine if you bid to say, I will provide, I don't know cleaning services for the city of Leeds for 100 million pounds. A year for the next 10 years, but it actually costs you 125. It doesn't matter that you won the bid. You'll never make money on it. It's just, it's, it's a terrible deal.

And now you're stuck with this. And these companies kept acquiring these bids and kept writing up goodwill from those acquisitions. And and, and, and they would acquire other companies. And so there would be more acquired goodwill and so forth. And they paid themselves out handsomely from the dividends of, you know, that, that they sort of basically through the accounting.

Now there was no underlying cash that it was just basically, it was the cash coming in from, you know, the public contract. But they weren't actually delivering on the under the underlying service until you get to a point where they [04:15:00] basically hollowed out the company into a shell and which has all of these obligations, but there's no cash left in the company.

And, and then the company just collapses spectacularly and this is how you can it was just such a profoundly sort of disruptive event here in the UK because career Carillion had become almost like a proxy for the government, you would go into a government and building or a government agency, and you would see Carillion because Carillion was the provider of that service.

And then suddenly overnight Carillion disappears. It doesn't have, it doesn't exist because it just can't, it just, the obligations are tremendous. And it turns out that there's, you know, the managers have paid themselves handsomely in this process. They they certain equity, not all equity holders, preferred equity holders inside equity holders have paid themselves tremendously handsomely in this process. And, and, and then there's nothing left. Now, how was this affected? This was affected by a series of changes in accounting rules that effectively took away what we call the stewardship perspective, which is the idea that you [04:16:00] don't pay out as dividends, things that you haven't earned.

You might have realized the cash when you signed the contract, but you haven't actually delivered the underlying service. So you haven't quote unquote earned it. We abandoned that earned principle. In how we think about dividend. This is, goes back to what I was saying earlier about accounting not being reliable and verifiable anymore.

When we took those constraints out of the Constitution, we were able to drop things like the earned criteria. So now you have this instance of, right. So it's, it's, it's things like that, that then add up and add up and add up and, and that's where I think it gets. Really, and of course, you know, it's like the, at the time when this is happening, no one pays attention.

It's when it, when, when the fact that something like Karelian just disappears, when people are like, wait, how did that happen? And quite frankly, most people don't understand even to this day, how that has happened because many of those rules are still around. They're, it's still completely legitimate to do what Karelian did.[04:17:00]

Elizabeth Doty: This is a fascinating and brilliant example of the kind of dialogue and exploration we like to do in these expert dialogues every two weeks with the CPRT. And there are ways you can go further. We're bringing these into conversations with government affairs and sustainability and DEI executives.

So please contact us if you'd like to discuss membership in the kind of inside view of these conversations, or go to the website, sign up. If you were a guest at this one, sign up to find out about more. We have a resource list that grows over time. We'll be adding these articles, Karthik that you've just referenced today, I think is really important additions.

You can follow us on Twitter at the Erb Institute or go to Karthik's faculty page at the University of Oxford to learn more. Thank you so much, Karthik, on behalf of the Erb Institute and to all of you for joining the conversation today. Take good care now.