**Buddhist Economics**
*Economics and accounting of the future?*

**Alan Shipman** So what might this future economic arrangement look like?

**Mike Lucas** Well I think it would be based on a more participative capitalist system where more people were involved in corporate ownership and in corporate decision making. Part of the problem of the existing system is that the majority of people are completely disconnected from the decisions that affect all our lives. If they were included and were able to influence decision making corporate activity would be more in the interests of people at large rather than just remote shareholders.

**Alan Shipman** It certainly sounds to me as if to an extent this might be leaning at an open door. A lot of managers are frustrated that they try to involve their workforce and motivate people but then they're still having to answer ultimately to these external shareholders somewhere else who are taking money out of the business. And I suppose it is the case that a lot of companies are re-visiting this issue of ownership because the pressures the stockmarket is putting on them and the way that it restricts what they really want to do strategically and in terms of employee involvement.

**Mike Lucas** Yeah. I mean I think that is happening but its still kind of very limited. And I think we need to go a lot further and a lot quicker and there is no guarantee that it is automatically going to happen because the majority of large corporations are still publicly floated quoted companies. And I think we need a new sort of financial engineering approach and one such approach has actually been put forward by the American economist, Jeff Gates, who has actually developed what he calls a an ownership solution whereby companies will set aside either by voluntarily or by compulsion if necessary a share of their retained profits each year which would be capitalised and new share capital created which could be conferred upon other stakeholders in particular employees so that this system could be incorporated within a democratic society where we still retain the rule of law on property rights because it wouldn't be necessary for the state to expropriate ownership rights of existing shareholders. But it would create more shareholders. So every year as a company grows a portion of retained profits are capitalised, new shares created and given to workers. And the idea is that if people who own a company are actually involved in the managing and the running of that company it's more likely to pursue goals other than profit maximisation than if the company is owned by and ultimately controlled by remote shareholders who have no actual intrinsic interest in the company itself are only interested in short term profits.

**Alan Shipman** That certainly sounds like a way of keeping capital in the business and spreading that capital through to the workforce without disowning the current shareholders who still keep their own stake in the business.

**Mike Lucas** Absolutely. Yes

**Alan Shipman** Is it easy to move towards that? It's been put forward as a model. Do we need a sort of legislative push before companies move in that direction?

**Mike Lucas** Possibly but not necessarily because I think it can be done partly by education. Senior executives through enlightened self-interest I think can be persuaded because otherwise the existing system is probably going to implode.

**Alan Shipman** We certainly have examples don't we of managers who have been doing that. People who set up a business, it's grown, they want to retire. They want to hand on a viable business and instead of floating it they've worked out a way of giving employees the shareholding often through a trust. So I guess this John Lewis model is catching on now and going into other parts of industry.

**Mike Lucas** Scott Bader is a company which I know quite well actually which makes chemicals and it has it's turnover now of I think two hundred million pounds and that was actually started by an entrepreneur who I think went public. It was a quote company then he bought the shares back and then when he retired he actually gave it to the workers and it's ever since been a very successful workers co-operative.

**Alan Shipman** And we have the examples of the Mondragon Co-operatives of Spain. We have SAMCO in Brazil. They seem to be companies that are able to grow very large and retain that ownership voice for the employees and the employee involvement in product development, enterprise development that goes with that.

**Mike Lucas** And again Japan of course. The great success of Japanese in the second half of the Twentieth Century was within a completely different ownership model. There was very few large Japanese corporations floated on a stock exchange. Mostly they were funded by the bank in a long-term relationship.

**Alan Shipman** And no one can dispute that Japan did very well out of that and it's noticeable that Japanese corporations continue to do well even though the Japanese economy has had it's own problems.

**Mike Lucas** I think the Japanese were a victim of their own success. The yen became over valued, which made it difficult for them to export because they were so successful and then they made lots of silly investments in American real estate at the wrong time. I don’t think it's an intrinsic weakness of their lack of pursuing the shareholder value model.

**Alan Shipman** And certainly the days when the British and the Americans could begin to laugh at the Japanese because suddenly the Anglo/American version seemed to be an improvement. Those days have long gone. We've seen the stock market, the market based solution as you say imploding quite severely in the last couple of years and a very expensive struggle to stop the stock market dragging the whole economy down. And an approach to banking over here which had become very much focused on the capital markets not on directly inputting capital to firms. So I think we have a lot of lessons to learn from the success of firms that were not based around shareholding and profit maximisation.

**Mike Lucas** Absolutely right because Japan and Germany for instance from mid twentieth century until almost towards the end of the twentieth century were actually far more successful than the UK and the US even though they were pursuing a completely different approach.

**Alan Shipman** Yes. And their productivity remains much higher than the UK’s which means ultimately that their average income remains much higher than ours. We might have sped up our growth a bit recently but we are still quite a long way behind. And we've seen Germany go through quite a renaissance recently showing that those stakeholder arrangements can still innovate, can still get capital going to new uses and it's not necessarily the Anglo/American model that innovates faster.

**Mike Lucas** Absolutely. I mean I think Toyota had something like sixteen times the labour productivity of General Motors, even though General Motors was a quoted shareholder owned company and Toyota was very much in the Japanese tradition because the stakeholders, the workers were engaged and felt a stake in a business in a way which workers in a disconnected system like US one didn’t.

**Alan Shipman** Yes Toyota is still teaching us lessons. It's got recall problems at the moment it still expects to make a profit despite the problems short term that it has with those. And they really showed the British and the Americans how to build cars the modern way. They set up plants which had a different structure and which did seem to have a direct employee involvement in the product which the old American and British carmakers hadn't managed. So how are we going to get to a non-shareholder model, which actually sounds to have an advantage?

**Mike Lucas** Well I think we need obviously alternative governance and ownership arrangements as we've discussed. But we also need a new accounting because accounting is a very powerful tool in society, which influences behaviour. Conventional accounting measures and reports profit and so managers within organisations are constrained to pursue profit because that's how they are measured and rewarded. At present we don't really have an alternative accounting model and that's why I am interested in trying to develop a Buddhist accounting model that would actually measure things that really matter which would be much more in the realms of human capital and environmental impact rather than the extent to which shareholder wealth is created.

**Alan Shipman** Yes I suppose at the moment we have tax accounting and management accounting and they are both narrowly focused on measuring profit and economists complain that it doesn't measure profit the way they want. But anything that economists propose is getting us to an even narrower measurement of profit. So we are losing sides with the wider stakes in that enterprise. And I guess also the long term. We have talked about the conflicts between long term and short term profit making accounting is really just a snap shot and it's looking at the here and now.

**Mike Lucas** Yes accounting actually encourages short term-ism even more than the natural tendency of managers to pursue short term-ism because pursuit of long term goals typically reduces short term profits because in order to invest in research and development or marketing or employee training for long term gain you are reducing this year's bottom line. And that's what accountants measure and report on.

**Alan Shipman** So we have to broaden what's measured right now and we have to lengthen the time horizon over which we measure it.

**Mike Lucas** if you measure – if you invest in research and development or employee training, accounting rules at present don't allow you to capitalise that. Those things although you have created in effect assets, intellectual property, you are not allowed under accounting rules to show those as assets on a balance sheet. They are written off as expenses. So the cost comes now whereas the benefit is going to be in future years. So there is every disincentive to managers to invest in market research and development employee training because the accounting model we currently have discourages that type of approach.

**Alan Shipman** So it's focusing us on the physical assets and not the human assets

**Mike Lucas** Yes

**Alan Shipman** And I suppose not the natural assets and the environmental impact either – two important dimensions that need to be introduced. And could we get there through people just adopting a new accounting system or does it really have to be led by regulators and legislators.

**Mike Lucas** I think it has to be led by the professional associations and the regulators because we have a very strongly entrenched regulatory framework now which is endorsed by company law as well as by sort of institutionalised practice that it would have to be propagated and controlled by the regulatory framework and the professional associations of accountants. But we are a long way from actually having an accounting model and a set of performance measurement tools that could be used even if business wished to pursue those goals. And there is a big research agenda for the future in universities for instance in developing new accounting models that can actually measure sensibly social capital, human capital, and environmental impact.

**Alan Shipman** But here again we might to a certain extent be pushing at an open door because there is certainly a lot of discontents with the current accounting system and a lot of reform activity is under way with regulators consulting industry on how new things could be measured and how existing things could be measured more broadly in a way that reflects the real value to the enterprise

**Mike Lucas** Yeah but I think that's kind of on the periphery. When I look at the main activity in accounting regulation and developing new accounting rules and regulations it tends to be more and more refinement of existing issues like how do we measure financial instruments. Should we mark to market or should we measure at historical cost – our physical assets or our financial assets. There isn't much going on if anything in the realms of how do we measure human development or the extent to which we are polluting the environment. Most of that sort of stuff is still in the way of a footnote you know. It's a narrative reporting which is still largely voluntary. There is very little if any compulsion on companies to report social and environmental impact for instance.

**Alan Shipman** Yes marking to market rings a particular alarm bell because that's one of the things that undermined the financial markets recently. And I suppose the lesson of this is we have to try to move beyond putting a monetary value on everything because then the things that can easily be converted into money get measured and managed. The things that are harder to convert the more human elements, are very often forgotten and it gives us a very narrow perspective on what the company is and where its value comes from

**Mike Lucas** Yes – hence the adage 'what you measure is what you get' you know

**Alan Shipman** But moving away from a monetary measure is the big challenge because I suppose it's saying economics isn't enough. Society has got to be brought into that picture and we can't just measure everything by what it would fetch on an open market.

**Mike Lucas** That's right. There has been an initiative in the past to develop social and environmental accounting. It kicked off in the sort of Seventies and Eighties but it kind of just died because it's impossible to quantify exactly the sorts of things we are talking about. And there was a kind of debate among accountants: is it better to accurately report irrelevant things or to broadly and less accurately report more important things? And the accounting profession decided for the former. Objectivity and accuracy was more important than whether what you were actually reporting on mattered or not. But it could have been otherwise.

**Alan Shipman** It could have and I suppose it was knocked off course by some factors, which we've moved on from. I remember inflation came in so suddenly inflation accounting became the big theme. And then we had this shareholder management revolution which seemed to be the way forward. So shareholder value became the big focus. We've seen that go wrong. We've seen financial markets have great difficulties. So may be the time has come to revisit those wider forms of measurement and to try to move those into the accounting mainstream again.

**Mike Lucas** That's a good point actually and inflation accounting is a very good example of the problems we face because originally within inflation accounting the approach was called current purchasing power which I think and most probably academics would concede is the most sensible approach to dealing with inflation. But it was actually defeated because of corporate pressure. It tended in a time of rising prices to reduce reported profits and was opposed by powerful industrial lobbyists and eventually it was dropped by the accounting regulators. So anything that actually looked bad for industry tended not to get incorporated. They moved towards current cost accounting, which was less injurious to industry. So apart from the recent mark to market debate inflation accounting was completely abandoned.

**Alan Shipman** But there is clearly a lesson in that. We end up with what might well be an inferior system of accounting because businesses had to push it in that direction and businesses did so because they were being pushed by shareholders for immediate profit and for measures that would maximise that when that may not have been in the businesses longer term interest. So I guess if we need a certain amount of external intervention to move the accounting system forward we're rescuing businesses from themselves or from their immediate pressures

**Mike Lucas** That's a good way of putting it.

**Alan Shipman** Part of the problem is that we have a perspective that requires everything to be funded and everything to generate a return. And so even our regulation to a certain extent is captured by this demand for return on investment and a business model that shows a degree of profit. Quite a difficult system to escape from but clearly a lot at stake if society is to get its enterprises working more in it's own interest.

**Mike Lucas** But we have to try.

**Alan Shipman** We certainly do.