FINANCIAL POST

Profit as motive must not be passe

Small firms exist to create returns for investors

Brad Cherniak, Financial Post Published: Monday, March 15, 2010

This is a column that should not need to be written, but there appears to be increasing confusion over what it means to be a business or a corporation.

Much of it is populist bluster, but increasingly we are seeing statements such as the one posted on Citigroup's website. Citi has been the recipient of billions in government largesse, as well as of populist attacks and back-handed slaps from politicians and commentators.

In response, they offered a shining New Citi paradigm: "Citi has an obligation to our clients and our stakeholders -- including the American public. It's an obligation to support the recovery of the U.S. economy, to reform our organization and to practice responsible finance."

So much of this is troubling. For one, the public is not a stakeholder in Citi; the shareholders and creditors are. The bank's only duty is to maximize returns to these stakeholders by doing everything it can within the bounds of the law.

Also, it has no obligation to support the recovery of the economy. And, the term "responsible finance" is insidious and would concern me greatly if I were a Citi stakeholder. They should practice finance smartly and aggressively -- innovating aggressively within legal bounds and, if successful, give back to the community.

A recent commentary in the NationalPost ("Fromprofit motive to forging value creation," January 19, 2010) seemed to suggest that profit as a motive for corporations may be passe and unenlightened, and that businesses' "stakeholders include customers, employees, suppliers, distributors, shareholders, the community, NGOs and the world at large." And that "doing business" should be more closely connected with "doing good."

While chilling, none of this is new. The stakeholder theory of economics first emerged 50 years ago at a World Economic Forum at Davos, Switzerland, whereby companies were hypothesized to have direct social responsibilities to a broad range of stakeholders, including society at large. It is a collectivist model tailored to

interventionist ideology. Until recently, it was not taken very seriously in mainstream Western economies.

But more recently, the model is being offered as an explanation of why market economies are fatally flawed and why the global economic tribulations were avoidable if only companies had been held to the communitarian standard of stakeholder theory. In other words, unbridled capitalism leads to excessive risk-taking.

In fact, it is just the opposite: Excessive risk-taking is facilitated when capitalism is bridled. Government intervention and misguided regulation and corporate governance separate, or obscure, pools of capital from their owners, blurring the line between public and private capital and turning the economy into one run by "other people's money."

If everyone is a stakeholder in every company, the notion of the company ceases to be meaningful. Another example of how pervasive this is, big U.S. investment banks became unwieldy, byzantine proprietary trading houses in part because they were no longer private partnerships -- rather they were run using other people's money.

To make matters worse, governments provided incentives for them to foster activities considered socially valuable, such as lowering lending standards to non-creditworthy families to broaden home ownership and encouraging securitization of their "subprime" mortgages as a way of financing the whole mess with other people's money. Ownership and reward decoupled -- core stakeholder theory, and a bad idea.

Small firms, on the other hand, cannot forget they exist solely to create returns for their financial stakeholders, given the razor-thin margin between success and failure. The only way to confer benefits to the broader community, employees, the country and charitable interests is to be successful.

Bottom line, if there is a cost a small business can cut, it must do it. Business owners are doing no one any favours by trying to become an employment agency or soup kitchen. They must never take their eyes off the bottom line. If a benefit is not directly quantifiable in their business plan, it is not a benefit --be it the environment or public health and welfare.

Let me be clear --I am all for protecting the environment, and reasonable government social programs. But countries need to maintain the ability to pay for them from a healthy, functioning private sector -- driven by the profit motive. It isn't driven by anything else.

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