The meaning of Mutuality in Business

Reflections I Mutuality in Business

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About the Author

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Colin studied as an undergraduate at Oriel College, Oxford, and received his DPhil from Oxford University in 1981. He was a Harkness Fellow at Harvard University, a Houblon-Norman Fellow at the Bank of England, the first Leo Goldschmidt Visiting Professor of Corporate Governance at the Solvay Business School, Université de Bruxelles, and has had visiting positions at Columbia, MIT and Stanford universities. In 1994, Colin became the first professor at Saïd Business School, and was appointed the Peter Moores Dean of the Business School between 2006 and 2011. He was the first Director of the Oxford Financial Research Centre at the University of Oxford between 1998 and 2005.

Colin has served on the editorial boards of several leading academic journals and assisted in establishing prestigious networks of economics, law and finance academics in Europe at the Centre for Economic Policy Research and the European Corporate Governance Institute. He was a founding editor of the Oxford Review of Economic Policy and a founding co-editor of the Review of Finance.

Colin was a director and chairman of Oxera between 1986 and 2010, and was instrumental in building the firm into what is now one of the largest independent economics consultancies in Europe. He is a director of Aurora Energy Research Limited, an energy modelling company. He has consulted for numerous large corporations and for governments, regulators and international agencies around the world.

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- The role of the corporation in contemporary society

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The Meaning of Mutuality in Business

1. Introduction

"I have seriously considered how far a man is justified in giving away the heritage of his children and have come to the conclusion that my children will be all the better for being deprived of this money. Great wealth is not to be desired and in my experience it is more of curse than a blessing to the families that possess it."[1]

So on 14 December 1900 George Cadbury, standing in front of the Friends Meeting House on the idyllic village green of Bournville near Birmingham with 370 cottages and five hundred acres of land around him, declared that he was giving away his wealth to the Bournville Village Trust. The aim of the Trust was "the amelioration of the conditions of the working class and labouring population".[2]

The idea of social welfare and reform was just emerging at the end of the 19th century spurred on by the writings of John Ruskin. Ruskin argued for an ethical approach to economic transactions and said that with wealth comes a moral obligation by which profit is only legitimate if it does not harm the rest of society.

Inspired by what George and his brother Richard Cadbury had created Joseph Rowntree, another Quaker, fierce competitor of Cadbury in the chocolate business and author in 1901 of *Poverty: A Study in Town Life,* created New Earswick on 150 acres near to York. And others followed the Cadbury and Rowntree lead – James Reckitt in Hull, Ebenezer Howard in Letchworth in Hertfordshire and Henrietta Barnett in Hampstead Garden Suburb. Business was not just responding to social reform but shaping it and the societies within which it operated.

Meanwhile a less wholesome aspect of chocolate production was taking place off the coast of West Africa. At the beginning of the 19th century, the Portuguese had

[1] Cited in Deborah Cadbury (2010), *Chocolate Wars – From Cadbury to Kraft: 220 Years of Sweet Success and Bitter Rivalry",* London: Harper Collins, p 176
[2] Ibid, p 176

introduced cocoa into the islands of São Tomé and Príncipe. The climate and rich volcanic soils of the islands made them well suited to growing the crop and in 1900 Cadbury bought 45% of its beans from São Tomé and Príncipe. But the Portuguese had imported something else into the islands as well – slave labour. The Portuguese officially ended it in the 1870s but in 1901 the board of Cadbury became aware of its continued use on its estates.

On 26 September 1908 the London newspaper, the Standard, published an article accusing Cadbury of blatant hypocrisy, claiming that: "it is the monstrous trade in human flesh and blood against which the Quaker and Radical ancestors of Mr Cadbury thundered in the better days of England".[3] The Cadbury board were aggrieved believing that they had done what they could to pressurize the Portuguese government "to put a stop to the conditions of slavery – not merely to wash our own hands of any connection with them" and that if they had withdrawn from the islands they would have lost the little influence they had over the Portuguese.[4] They sued the Standard for libel and on 29 November 1909 the case came to court. The jury found in favour of Cadbury but awarded damages of "one farthing" clearly unimpressed by how Cadbury had handled the slavery issue.

Was Cadbury a mutual business? Did the creation of the village of Bournville demonstrate a mutual approach to its employees? Did its concern about social reform reflect a mutual attitude towards business? Was its continuing sourcing from plantations that employed slave labour and its failure to effect social reform in West Africa a violation of mutuality?

The answer to all these questions is in some respects yes and in some respects no. In particular, the history of Cadbury exemplifies the distinctive features of mutuality.

2. What is Mutuality in Business?

On 28 July 1947, Forrest E. Mars wrote a note in which he set out his vision for Mars Incorporated. This was that Mars Incorporated should "promote a mutuality of service and benefits among its consumers, distributors, competitors, suppliers, governments, employees and shareholders". He described this as "the total purpose for which the Company exists". It has become one of the five guiding principles of the company along with quality, responsibility, efficiency and freedom.

[3] Id., p 213
[4] Id., p 214

The only question is what does it mean? In popular parlance, the term mutuality has a particular connotation. The Oxford English Dictionary describes the definition of "a mutual company" as being of U.S. origin dating back to 1784 in Pennsylvania "designating or relating to a financial institution (as a building society, insurance company, etc.) without capital stock, that is owned by its members who subscribe to a common fund from which claims, loans, etc., are paid, profits after deductions being shared between them". In other words it is a form of ownership and sharing of the profits of the firm amongst its members that stands in contrast with a stock corporation.

The sharing of profits is clearly a crucial component of both Forrest Mars' and the common concept of mutuality. But as it has come to be interpreted by the Mars Corporation, it has elements that are both more and less than the popular understanding. It is less in so far as with mutual ownership come rights to participate in the control of the organization that derive from voting as well as income claims. Mutuality as understood in Mars does not have these associated voting rights. The ownership of the company remains entirely in the hands of the family and voting control therefore is solely restricted to the family. However, the company attaches immense importance to the participation of its employees in all aspects of decision taking and regards consultation and consensus as being core to its *modus operandi* as reflected in the term "associates" to describe its employees.

At the same time, Mars perceives mutuality as more than its common interpretation in so far as it extends beyond being just a legal form to encompass the notion of flourishing of both the organization and the individuals who are associated with it. This perhaps comes closest to Forrest Mars' concept – the mutual flourishing of the company and all those associated in one form or another with it.

Furthermore, and this is where the concept as it is understood in the Mars context has perhaps the greatest insight, the two forms of flourishing are mutually reinforcing – the flourishing of the company is conducive to that of the individuals associated with it and the flourishing of the individuals associated with the company promotes the company itself. It is in other words reflexive between legal form and the human participants.

There is not only a belief that mutuality is conducive to these reinforcing benefits but that it is necessary - without it businesses will not flourish. It is not sufficient in so far as there are at least four other principles of quality, responsibility, efficiency and freedom that are of importance but it is at least one of if not the most important of the five principles.

What if anything is the underlying basis of this notion of mutuality – sharing to the benefit of those who share in the benefits and to the benefit of the company that does the sharing? The next section places the concept in the context of an economic and business perspective of the organization to explore its basis and validity.

3. A Framework of Analysis

The firm is conventionally regarded as a production function of different forms of inputs – capital, labour, land and materials – and a nexus of contracts that binds these different parties to the firm together with their customers and suppliers. Figure 1 illustrates this in the context of where there are two factors of production – capital (K) and labour (L) – and two parties – the owners (O) of the capital and the workers (W). The owners combine the capital that they possess and do not give to the workers with the labour that workers supply them to produce output Q_o. The workers combine the labour they do not supply to the firm with the capital that the owners have given them to produce their own entrepreneurial output $Q_{w.}$ The figure shows the combination of capital and labour that allow the workers and owners to achieve particular levels of output Q_w and Q_o respectively with the origins of the output of the two groups (O_w and O_o) in the opposite quadrants of the diagram.

The owners are rich in capital but poor in labour skills. The workers are rich in labour but without capital. They are currently both at point A (autarky) on the diagram. There are therefore "gains from trade" in the sense that both parties can achieve higher levels of output and in particular achieve Pareto efficient outcomes along the line BB' (the "best" outcomes) where the output of one party is maximized subject to a particular level of output of the other. Conventional theory suggests that market prices exist that sustain a point on this efficient frontier.

The problem that arises and that the owners and workers seek to resolve is whether the two parties can commit to deliver outcomes that are superior to autarky let alone Pareto optimality. Take for example the point B' which is the Pareto efficient outcome that is most favourable to the workers W. This involves the owners providing capital K_w^2 in return for workers supplying labour (L_w^A - L_w^2) to the firm, keeping L_w^2 for their own entrepreneurial activities. This allows the workers to achieve an output of Q_w^5, which is in excess of their output Q_w^1 in autarky at A.

The problem is that by defaulting on their promise to supply (L_w^A - L_w^2) and combining the capital K_w^2 with all their labour supply L_w^A, they can achieve a higher level of output still of Q_w^6. That will push the owners' output down to Q_o^6, which is below their level of output Q_o^2 in autarky. Anticipating this, the owners will refuse to give the workers the capital K_w^2, leaving everybody in the position of autarky, A. This is illustrative of how choice that adversely affects other parties is a burden of the human condition that has afflicted mankind since Adam and Eve in the Garden of Eden.

The workers need a way of being able to commit to supply labour. There are two possibilities. The first is that the workers put up a bond as surety for the capital and the supply of their labour and suppose that bond is worth K_w^1. In that case the owners know that in the event of the workers defaulting they can recover K_w^1. They will therefore be willing to supply that amount of capital in return for the workers supplying (L_w^A - L_w^3), allowing point D to be reached yielding the same level of output as in autarky for the owners and Q_w^2 for the workers from their entrepreneurial activities. This is not as much as their output at B' but more than at A.

What happens if, as may well be the case, the workers have nothing that they can offer as a bond? In that case a second possibility is that the owners can withdraw up to K_w^1 of the capital they supply in the event of the workers defaulting on their promised supply of (L_w^A - L_w^3). That would pull the workers entrepreneurial output back to autarky Q_w^1. By offering the workers more than the output that they can achieve in autarky, Q_w^1, the threat of losing their profit Q_w^2 - Q_w^1 encourages honesty on the part of the workers.

This does not work in the absence of a surplus accruing to the workers. If the workers had been required by the owners to supply labour L_w^A - L_w^1 in return for capital K_w^1 to reach point C and the same output as in autarky namely Q_w^1 then the threat of removing capital as a consequence of them failing to supply their promised labour leaves them in the same position as if they had supplied the labour. There is no punishment associated with the threat of removing capital in the absence of the workers earning a profit. Profit is an inducement to honesty.

The same holds in reverse for the owners. If there is a risk of the owners defaulting on their promise to supply capital K_w^1 allowing them to achieve point H instead of D and output Q_o^7 then the threat of withdrawing labour will merely push the owners' output back to autarky Q_o^2 at A, the same as at D. There is no punishment associated with default if workers were in any event extracting the entire surplus. However, if the workers were offering labour of (L_w^A - L_w^1) then they can impose a loss of (Q_o^1 – Q_o^2) on the owners by withdrawing their labour and returning to autarky. So the workers can induce honesty on the part of the owners by sharing profits with them. Together the observations on workers and owners mean that profit is not just an inducement to honesty but the mutual sharing of profit is a mutual inducement to honesty.

This points to two observations. The first is that in the absence of the ability of parties to post bonds then profit is essential to the promotion of honesty and the avoidance of default. Second that in a reciprocal arrangement, which relies on the honesty of more than one party, then mutual sharing of profit is required to promote productive relationship between the two parties. The mutual sharing of profits is central to the generation of profits that in turn are critical to mutual arrangements.

Third, if one party can post a bond and the other cannot then the party that is unable to post a bond should receive a majority of the surplus as an inducement to honesty on their part which the other party can assure through the bond. So for example, if owners have collateral that they can post as bonds and workers do not then the distribution should be closer to point D than point C. In essence, current distributions of profits are determined by past accumulations with allocations to those with small accumulations being justified not just on fairness but also on efficiency criteria.

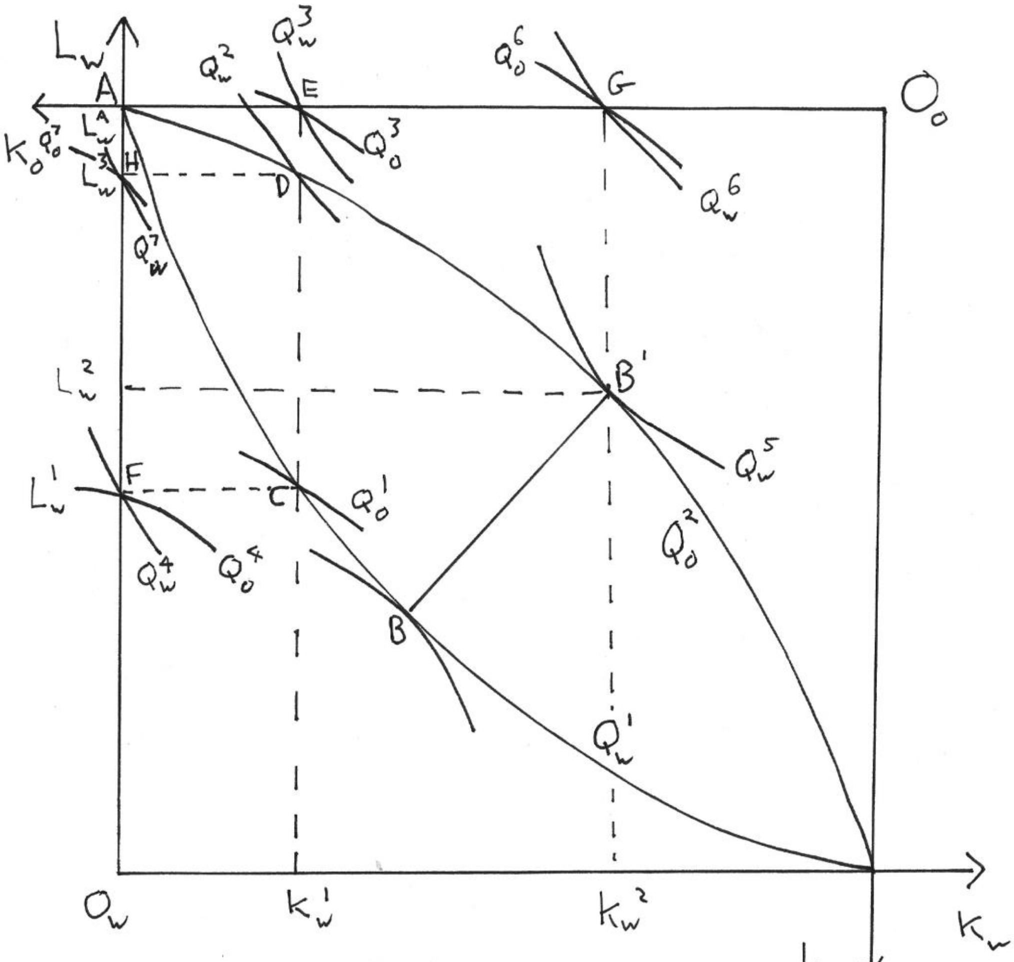
4. Conclusions

With this as a framework, let us conclude by applying it to the questions that were posed about Cadbury at the end of section 1. First, if Cadbury built Bournville without any anticipated reciprocal benefit to Cadbury's commercial activities, it was operating at point E or G on Figure 1. This is not a mutual arrangement but pure philanthropy. If Cadbury anticipated a corresponding input of labour associated with at least points D or B' then this might have been used to encourage a dedicated workforce that risked losing its benefits if it failed to meet its employers' expectations.

Second if social reform and the responsibility of owners were perceived to be important then the distribution of profits to owners at points C and B could be viewed as part of the inducement to responsible conduct. In other words, workers forgo a significant share of profits in return for a commitment on the part of owners to supply the capital that is required to maintain economic activity. If that commitment can come from posting past accumulated capital as a bond then a larger share of profits can accrue to workers as an inducement to honesty on their part.

Finally, the failure of Cadbury to sustain human rights in Africa pushed them to an exploitative position at F. Cadbury had a particular responsibility to ensure that minimum standards of human rights were upheld in regard to workers who were not able to withdraw their labour as slaves. Cadbury therefore seriously violated principles of mutuality by allowing conditions at F to prevail.

This framework should therefore assist in understanding what is meant by the notion of mutuality, its significance in promoting economic activity and the factors that influence the appropriate sharing of benefits in a mutual relationship.



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Q_w^5
Q_o^1
Q_o^2
Q_w^4
Q_o^4
Q_w^1
O_w
K_w^1
K_w^2
K_w
L_o

FIGURE 1

Saïd Business School

Saïd Business School at the University of Oxford blends the best of new and old. We are a vibrant and innovative business school, yet deeply embedded in an 800-year-old university. We create programmes and ideas that have global impact. We educate people for successful business careers, and as a community seek to tackle world-scale problems. We deliver cutting-edge education programmes and ground-breaking research that transform individuals, organisations, business practice, and society. We seek to be a world-class business school community, embedded in a world-class university, tackling world-scale problems.

Mars Catalyst and the Economics of Mutuality programme

Mars' approach to business has been guided by Five Principles – Quality, Responsibility, Efficiency, Freedom and Mutuality for a long time. Together they inform and guide the actions of all Mars associates every day as they do their jobs and interface with the outside world.

The origins of the Mutuality principle go back to 1947 when Forest Mars Snr who led and grew the business through the 1920's to the1960's, wrote a letter to all the then 500 associates of the company that said that the sole purpose of the company was to create a mutuality of benefits with all stakeholders that the company touched from suppliers to customers as well as governments and competitors and naturally associates and shareholders. This far-sighted thinking, that the company could only be successful if everyone around the company was being successful, has been a cornerstone of our business philosophy ever since.

Mars has therefore always been interested in how it can best live up to this principle and find new ways to drive mutuality with all stakeholders it touches. This led, a number of years ago, to Mars leadership tasking Mars' economic research unit, Catalyst, to start new work into unexplored territory for business to identify critical drivers of mutuality and to develop and test through business pilots new metrics and management practices that can help boost mutuality in business situations. This work has been called the Economics of Mutuality.

This work has established promising links between increasing social, human and natural capital (that can be measured with simple & stable metrics) and thereby increasing financial capital – demonstrating how a company can do both good and well at scale. A number of pilots have now been completed in the area of micro–distribution, the employees of Mars and in agricultural development that suggest that these relationships are true in different places and situations.

The Oxford Mars partnership

On the back of these promising findings, a multiyear partnership with Oxford University's Said Business School was established in 2014 to focus on the development of a business management theory for the Economics of Mutuality with corresponding teaching curriculum, new management practices, and case study research. The research programme has combined the pursuit of normative questions – what is mutuality and how should it be enacted? – with grounded, ethnographic research on current thinking and practices. This has led to the development of field experiments and case studies examining how large corporate actors conceive of and pursue responsible business practices, and how these relate to their financial and social performance.

The broader idea being to demonstrate that businesses based on mutuality, that look to ensure all stakeholders are successful, can be more successful than businesses that focus on just their shareholders.

The intent going forward is to continue to research this topic and create a broader platform where other companies and academic institutions can share their learnings and experiences to advance the collective understanding of how to drive mutuality in business.

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