Public Interest Capitalism
& Asian Economy

About George Hara

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In 1984, Hara founded DEFTA Partners and became a partner at Accel Partners in the 1990's. Hara helped to create and manage I T firms as chairman, board member of companies such as *Borland* (2nd largest PC software), *PictureTel* (teleconference),*Oplus Technologies* (Merged with Intel in 2005), *Broadware* (merged with Cisco in 2007), *Transitive* Technology (merged with IBM in 2008) and *Fortinet* (NASDAQ IPO in 2009). While creating ventures in advanced nations, Hara founded DEFTA Development Holdings to bring cost effective information infrastructure technologies to less developed countries in Asia and Africa through private and public sector initiatives.

In the public sector, Hara serves as Chairman of the *Alliance Forum Foundation*, an international organization in special consultative status with the UN Economic and Social Council. He has served on the boards of the San Francisco Opera, San Francisco Zoo, University of San Francisco, Tokyo Foundation, and Hara Research which offers fellowships for interdisciplinary between life& computer science. Hara was a UN Fellow and h olds LL.B. from Keio Univ. and M.S. from the Graduate School of Engineering at Stanford University.

Do corporations belong to shareholders?

In discussing this century's economy, what interests the world the most is financial crises that occur every year. Crises like the one after the fall of the Lehman Brothers, which were said to happen only once every 100 years, have come to be a yearly event since 2008.

Intellectuals of our time have come up with 3 prescriptions to this situation: (1) a strengthened supervision through more financial regulations, (2) the establishment of funds and international investment frameworks that would prevent the chain reactions of these financial crises, and (3) the promotion of an ethically-based operation of finance. In reality, however, the issue of increasing financial crises remains unsolved, and none of these prescriptions will lead to a complete cure.

To address these financial crises, while macro-level problems of the financial system are being discussed across the globe, there is little analysis done about the kind of decision-making mechanisms that cause financial crises. The real problem is, however, the fact that the "corporations-belong-to-shareholders" ideology, serving only the short-term interests of shareholders, lies behind the decision-making processes. In order to get to the bottom of financial crises, this ideology needs to be tackled.

Disseminating a New Financial Model from Asia

The very basic of finance is the "visible-face operation." Imagine: you are a banker, and a young man with a business plan in his hands comes up to you, asking for a \$500,000 loan. Even the most knowledgeable and successful banker would not possibly possess every know-how in all industries. In other words, the analysis of his business plan is not the ultimate decision maker's job. What is important for you to do would be to evaluate the young man as a person. Continuing with this example, once you determine that he is competent, you would start by lending him \$50,000 that is necessary in his first 6 months of operation, not the whole \$500,000. Then, if you could further feel his passion and effort and see that everything is being proceeded as planned, you would loan the next \$100,000 and eventually the remaining \$350,000.

The "visible-face" operation of banks, however, is often frowned upon by shareholder capitalism extremists because it does not raise return on equity (ROE) and share prices. Giant funds, which loudly claim that corporations belong to shareholders, put enormous pressure on management teams to implement mechanisms that would raise share values. This is the context where new financial products were thought of. Not only do these products mock the essential spirit of the financial operation, but they also have become tools with which only the interests of shareholders and the management are pursued. These tools have gone through further complication and evolving, giving birth to subprime mortgage, a very dangerous financial product with the safest, AAA rating.

While the world economy is increasingly warped, the "visible-face" finance is actually thriving in Asia. One such example is microfinance which began in Bangladesh. It is one of the founding financial mechanisms in what I call "Public Interest Capitalism," a new model of economy. The creators of microfinance are Sir Fazle Hasan Abed and Muhammad Yunus, founders of BRAC (formerly the Bangladesh Rural Advancement Committee) and the Grameen Bank, respectively.

Microfinance represents small uncollateralized loans for the poor. By providing alternative windows for "those who are healthy and passionate yet poor and unable to borrow money from financial institutions" and thereby giving them opportunities to operate small businesses, microfinance is generating innovative routes out of stagnant cycles of poverty. Microfinance today has developed into a "visible-face" financial business, offering not just access to loans but also access to the market and occupational training. Countries that have adopted microfinance can already be found in Asia, Central and South America and Africa. This concept will play a central role in finance of the 21st Century. A new era of finance based on public interest capitalism – which would lift the impoverished into the middle class – will replace the current one of extreme shareholder capitalism – whereby the rich become richer.

For this shift to happen, institutions nurturing microfinance bankers are required. To my surprise, however, neither BRAC nor the Grameen Bank holds such a body. As such, in 2009, the Alliance Forum Foundation established the Microfinance Graduate Program in cooperation with the two organizations. The number of graduates of the Program exceeds 100 as of February, 2012. Amongst them are those who will knock in a wedge into poverty in developing countries by laying out the basis of industries with microfinance banks.

Public Interest Capitalism and 3 Indices

Problems of capitalism were finally discussed at the World Economic Forum in 2012. Nonetheless, the discussion took a form of whether or not Westernstyle shareholder capitalism is better than China-like state-led capitalism. To tell my conclusion first, the two share a commonality in that neither provides happiness to citizens. I would like to popularize public interest capitalism in Asia as the "third" way. *PUBLIC INTEREST CAPITALISM* is a movement that promotes the creation of corporations beneficial to the society while taking advantage of the profit-hungry nature in our greed-based economy. The base notion of public interest capitalism is the establishment of a new framework that can grow *the* industry, a new growthgenerating engine of the world. It is then imperative that efforts to create *the* new industry are met with ample financial resources, even though high risks are involved.

I will raise 3 points to make finance available and accessible to *the* new industry that is beneficial to the society. I call these three the public interest capitalism indices. If these indices become the foundational logic just as stock-price-linked ROE is now, the world will go through a dramatic change.

The first index is sustainable management. A corporation ought to be able to sustain itself and protect its employees with the internal reserve, even in the face of natural disasters like earthquakes and tsunamis. It is also only when internal reserves are plenty that high-risk research and development can be pursued. As such, it is important to build and maintain internal reserves. However, today's hedge funds and shareholder activists, who advocate for the maximization of shareholder interests, threaten corporations with high retained reserves that nonurgent reserves are not be retained but to be distributed as dividends. Public interest capitalism emphasizes sufficient internal reserves as a going concern for operational sustainability – which then allows such a management style to obtain a higher share value. In other words, the prevailing logic – that the more internal reserves a company holds, the lower its ROE is – would no longer hold.

The second standard is a corporation's willingness to improve. More specifically, pursuits of innovations should include safety and security assurances. Such efforts, however, are rarely reflected in stock values as they are not considered a determining element of ROE. Take the Central Japan Railway Company, for example, which has never experienced one deadly accident in its bullet-train operation, even under its former name, Japan National Railways. This is a proof that the company has spent both human and financial capital to provide safety. Yet, not only are the share values unreflective of such factors, but funds demand that all resources spent on safety assurance be minimal and that the rest be distributed as dividends.

The third measurement is the fairness of wealth distribution. The CEOs of the top 50 U.S. companies earn a whopping 300 to 600 times more than an average worker. In Japan, the income difference is about 10 to 15 times between CEOs and average employees. Considering the gap in job responsibilities and burdens, however, the Japanese income difference would probably be too small. Then, let us find a common ground between the U.S. and Japan by taking the going rate in the 1980s in America when a CEO's income averaged 30 times more than that of an ordinary worker.

If pursuing these three standards were to lead to a rise in share values, greedy Wall Street would gladly invest in companies that do exactly that. The corporations, satisfying these indices, would allocate resources with a mid- to long-term vision, provide stable employment, and generate safe products and services.

Not just the financial industry on Wall Street but also the leaders of treasury and finance ministries and central banks in the world including Asia are comprised of elites who learned neoliberal economics, which has become the founding block of the current regime of extreme shareholder capitalism. What is needed now is to come up with prescriptions under the framework of public interest capitalism addressing the extremism based on neoliberalism and China-like state capitalism before they completely overshadow the world.

Aiding Developing Countries from the Private Sector: DEFTA-bracNet Model

Pragmatical delivery of public interest capitalism includes the private sector's aids to industrializing countries. Currently, there seem to be three approaches to the issue of poverty in the developing world. The first approach is governmental support from the industrialized, also known as ODA – Official Development Assistance. It is done using tax revenues of wealthier nations. The second form of aid is through charity. Religious organizations and philanthropic foundations engage in this kind of activities. Third, the private sector also contributes to industrialized nations' effort to aid poor countries as represented in the "DEFTA-bracNet model." I initiated this privately-operated model in 2005 in Bangladesh. It operates in the following fashion: (1) establish a for-profit organization, "bracNet" in cooperation with BRAC, and (2) profits after taxes are distributed in accordance with the shareholding ratio – 60% owned by DEFTA and 40% by BRAC. While KDDI acquired 20% of the share in 2009, which lowered BRAC's ownership to 20%, much more revenue repartition benefits the public than a typical CSR program.

Even though bracNet is a broadband internet provider with cutting edge telecommunication technology, the DEFTA-bracNet model can be adopted and modified by other Japanese firms to address many problems such as energy shortages and malnutrition. Western corporations will follow these models sometime very soon. Business operations innovated in industrializing nations under the new capitalism can spread to not just overseas subsidiaries of Western but also local firms. Accumulated, such business operations and models will lead to a nation-building based on public interest capitalism.

Bhutan, for example, was able to declare its slogan, "Gross National Happiness" only because it was a small country that just had opened up its economy after a long period of national isolation. With one foreign investment coming after another, such a custom will fade away in no time, whether the country recourses itself toward an Western-style shareholder capitalism or a China-like nationally-led capitalism. There are several Asian countries in need of a new capitalist framework, including Myanmar, Laos, and Cambodia. Not to mention, a new form and model of capitalism will be hoped for even in China and India – whenever a political instability is observed.

Towards New Japanese Economy: in Coalition with Asia

In a *Yomiuri* article on March 6, 2003, I argued:

"American capitalism has a possibility even to destroy all socially beneficial corporations. This is because of a wicked notion that corporations belong to shareholders, which has become the base concept of corporate governance. More specifically, publiclyheld corporations are of a 'public' nature – that comprehensively represent employees, customers, and suppliers (i.e., not just shareholders). A shareholder with a long-term ownership of a company – 5 years at the shortest – would be a real 'owner' with an intention to support the company's growth. The majority of American shareholders, however, aim to raise share values in a quick-fix fashion and to sell at higher stock prices. In other words, the problem lies exactly here: they proudly claim a restoration or a revitalization of a company while intending only to maximize their own shortsighted profit."

Modern financial institutions have led many valuable companies to a collapse. Now, however, a new form of capitalism – in compliant with public interest capitalism – is about to be born.

The Western shareholder capitalism, since the colonial era, has not been able to bring happiness to Asia. While, on the other hand, the Chinese-style national capitalism has momentum now, it is questionable as to if that would last. As I mentioned earlier, the Chinese form of capitalism also does not make people happy. Then, Japan is expected to make an alliance with Asia, with new ideas based on public interest capitalism. What Japan should aspire to be is a country that can build mutually beneficial ties with Asia – the most populated economies of the future – by championing a new economic model rooted in public interest capitalism.

At the same time, it is imperative to make the mechanism of public interest capitalism the dynamic force that generates new sustainable industries while formulating an appropriate taxation system, a financial and securities scheme, an accounting structure and a regime of corporate law. Although doing so would require risk-taking and much time, let us help craft new Japan where ample investment is allocated into new enterprises and projects, leading to many births of new industries with high added value. Western nations will then follow our country.