

E nriching Lives of People in Developing Countries through Public Interest Capitalism

By George HARA

Introduction

In the mid-1980s I established DEFTA Partners as an operating holding company and venture capital firm to discover, invest in, and nurture early-stage information technology companies in Silicon Valley. Through these activities, I have engaged in the development and management of a wide variety of companies, many of which have become large global enterprises. Working in this field, I have become acutely aware of a number of problems that exist with capitalism in its current form and have continually raised my concerns over the damaging impact of both financial capitalism and shareholder-centric capitalism. Public Interest Capitalism is a concept that I developed to address the fundamental problems that exist with present-day capitalism. At the core of this concept is an emphasis on the “public interest,” which has long existed in Japanese society. I strongly believe that Public Interest Capitalism has the ability to make a tremendous contribution to the growth of developing countries, which have all too often been at the mercy of existing capitalism structures and its logic.

In conjunction with establishing the theoretical elements of Public Interest Capitalism, I have also been working to actually implement these elements through the establishment and management of a major business enterprise in Bangladesh, one of the poorest countries in the world. In addition to this undertaking, I am also working to help spread microfinance as I believe that it is inherently linked to Public Interest Capitalism. In the following article, I will briefly describe the elements of Public Interest Capitalism, detail my activities in Bangladesh, and explain my current involvement with microfinance. Eventually, I hope to implement these projects in developing countries across Asia, Africa, and Latin America.

Money Capitalism & Shareholder-centric Capitalism

There was an initial period, following the burst of the financial bubble in November 2008, in which some investment bankers and Wall Street executives called for a reexamination of money capitalism and the development of a new system for global financial markets. As stock prices have recovered somewhat, much of this thought has been quickly brushed aside. As long as money capitalism is allowed to continue unchecked, I am afraid that similar bubbles will continue to occur, impacting the world and its citizens. The financial sector exists to play an important role in support of industry, not the other way around. However, as financial engineering has progressed and tremendous profits have been made, society has mistakenly assumed that it deserves an equal or greater role. As a result, some countries like the United States and Britain have all but abandoned the time-intensive manufacturing sector

under the mistaken belief that the finance sector, with its ability to produce short-term windfalls, will become the core industry for the next generation. It is this overemphasis on the financial sector that lies at the root of the stagnation of both Ford Motor and General Motors in the United States.

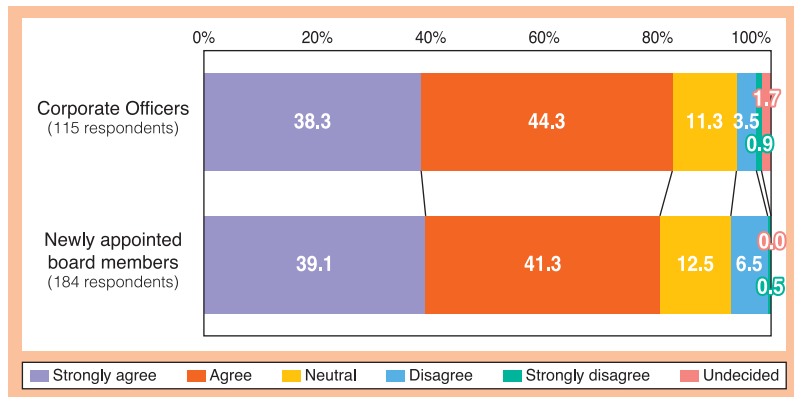
It is not money capitalism alone that is fraught with problems. Shareholder-centric capitalism is also to blame for a number of problems afflicting our economy and society. At the heart of shareholder-centric capitalism is the concept that before anything else a company should pursue profits for its shareholders as its first priority. This line of thinking has created an overall business environment in which management has a tendency to pursue short-term profits and forsake the accumulation of adequate internal reserves necessary to sustain future operations, instead regurgitating them to shareholders in the form of dividends. This type of short-sighted management is particularly disastrous for companies in the manufacturing sector since these firms require a certain amount of internal reserves to support long-term research and development activities aimed at creating new technologies and products. Significant reductions in internal reserves often force companies to focus the majority of their R&D efforts on technology that will come to fruition in the short term, diverting investment from more long-term projects which may have a greater benefit for society.

An additional negative aspect of shareholder-centric capitalism is the determination of a company's value solely based upon the performance of its stock price. This situation has worsened as stock options have become a popular incentive for CEOs, directly aligning their interests with those of the company's shareholders. The result has led to a tendency for management decisions to be made to control the stock price rather than to pursue the long-term interests of the company. This can often be the case when a newly appointed CEO joins a firm and immediately begins a sizable restructuring that involves posting losses and an ensuing reduction in the share price. In such situations, the CEO is often provided stock options at an extremely low price, which he or she will then exercise after cost reductions have taken effect, the balance sheet tweaked and the stock price has moved higher. This type of maneuver has often been used by short-sighted CEOs to the long-term detriment of their companies, particularly in the United States. Another trick used by reckless management is to drive up the stock price in the short term by artificially increasing return on equity (ROE). This can be done by exhausting internal reserves and reducing stockholder's equity (the denominator of the ROE equation) to increase a firm's ROE and drive up its stock price. This type of management in which a company's undistributed profits and internal reserves are excessively distributed in the form of a dividend to stockholders to increase ROE can actually harm a company's long-term prospects, especially when the company operates in capital-intensive industries or indus-

CHART 1

A Survey of executives regarding Public Interest Capitalism

The results of a 2009 survey showed that over 80% of newly appointed board members and corporate officers in Japan responded that they agree with the concept of "Public Interest Capitalism".



Source: "12th Close-up Survey of New Executives" (August 2009), Japanese Management Association

tries where long-term R&D is vital. Yet, it is a common practice among activist fund managers to advocate that company management drive up ROE through this method. By combining this with the skillful use of investor relations (IR) that champions the company's future prospects, oddly enough the company's stock price increases.

In this way, financial capitalism and shareholder-centric capitalism have had a negative impact on the manufacturing sector and the real economy. In the United States and Britain in particular, it has become painfully obvious that this type of capitalism eventually leads to a decline in industry, inequality in income distribution, and ultimately the erosion of society. Moreover, this style of capitalism has also effectively worked to impede the cultivation of industry in developing countries and prevent long-term development in these nations.

Public Interest Capitalism

Beginning in 1995, the Alliance Forum Foundation, for which I serve as chairman, has sponsored a number of activities throughout the years to promote research into the shortcomings of money capitalism and shareholder centrism. Beginning in 1999, our foundation has taken this a step further and assembled a team to work on a theoretical basis for a new form of capitalism called "Public Interest Capitalism." The concept of creating value not just for shareholders, but also for employees, customers, vendors and the local community has naturally permeated through traditional Japanese corporate management practices (Chart 1). Public Interest Capitalism is rooted in this concept of providing value to a company's entire array of stakeholders to drive the company's sustainability and long-term success. From a long-term perspective, this approach creates far more value than the shareholder-centric capitalism that is practiced today.

In order to fully develop this concept and spread it across the world, I have been working together with a team of researchers from universities such as Harvard. Our team has just finished a detailed analysis of problems that occur under shareholder-centric capitalism. We are now moving into the next phase of this project in which we will build a structure around the theory of Public Interest Capitalism by examining case studies of management that conforms to this concept.

I believe that three primary indicators exist to determine if corporate management decisions are being made in the public interest. These indicators can be summarized as "fairness, sustainability, and ongoing improvement and advancement." Fairness refers to the need to confirm that corporate profits are being appropriately passed onto employees. This indicator is also useful to measure employees' loyalty to the company, their dedication to continually improve and their motivation to innovate. In the United States, the gap between the compensation of executives and that of the average employee has grown exponentially over the last couple of decades.

So much so that in 2006, the ratio of executive pay was more than three times that of the average employee. (AP data based upon Institute for Policy Studies and United for a Fair Economy calculations). I suspect that this excessive gap in compensation has had a negative impact on industry in the United States by eroding ordinary employees' sense of allegiance to firms and significantly reducing the pool of knowledge and experience within most companies.

Sustainability, the second indicator, involves constant confirmation that management decisions are being made from a long-term perspective. This is particularly necessary in the case of assessing the level and quality of investment allocated to long-term research and development and other investments for a company's future operations. Under this indicator, the depletion of internal reserves to satisfy activist fund demands for increased shareholder dividends can be deemed problematic.

The third indicator, ongoing improvement and advancement, basically measures a company's flexibility and adaptability to change. This indicator checks the level to which a company and its management pursue continual improvement within the organization at all levels. These three indicators that I have mentioned serve to identify whether or not corporate management is making decisions from a long-term standpoint and whether employees are working vibrantly. Together, these indicators and their interlaced factors form the basis for Public Interest Capitalism-based management. Going forward, I will work to spread these indicators and the theory of Public Interest Capitalism into the fields of economics and management. By doing so, I hope that we can develop an alternative form of capitalism which develops corporations across the world that enrich the lives of individuals and bring forth a new age of global economic stability.

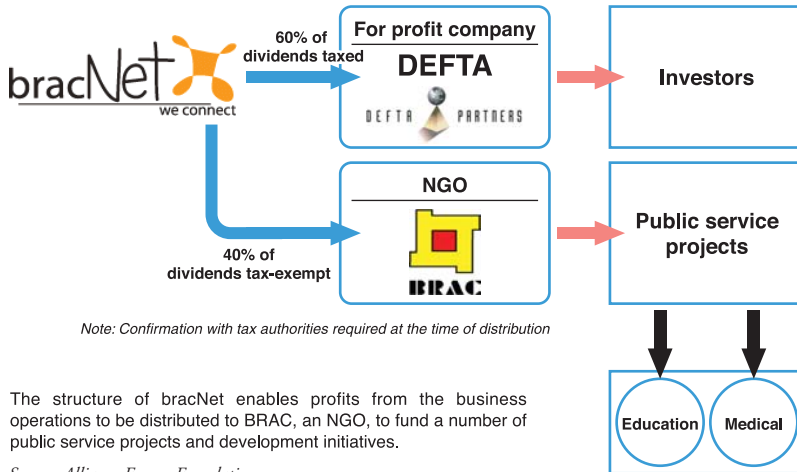
Establishing Public Interest Enterprise in Bangladesh

In order to move beyond theory and illustrate the efficacy of Public Interest Capitalism in the management of a living and breath-

CHART 2

bracNet business model & Public Interest Capitalism

Circulation of funds between for-profit business and public service projects



Note: Confirmation with tax authorities required at the time of distribution

The structure of bracNet enables profits from the business operations to be distributed to BRAC, an NGO, to fund a number of public service projects and development initiatives.

Source: Alliance Forum Foundation

Photo: Alliance Forum Foundation



One of bracNet's "e-huts" or rural business centers can also be used as a training center for distance learning and telemedicine initiatives.

ing enterprise, I started a for-profit company that embodies this concept. To begin with, I wanted to materialize a model for this approach in the developing world since many developing countries have sadly suffered at the hands of our present-day capitalist logic. With this in mind, I established bracNet, an Internet service provider (ISP) in Bangladesh, in 2005 to serve as this model.

bracNet is unique for a number of reasons. First, the company has been extremely successful in deploying a high-speed wireless broadband technology called WiMAX to provide low-cost Internet communication for a wide range of customers in Bangladesh. Before bracNet, ISPs in developing countries mainly focused on developing infrastructure for business users only because of significant cost issues involved with building infrastructure to provide service to the general public at large in these countries. As a result, rural Internet access was

impossible. bracNet, on the other hand, endeavors to build nationwide broadband infrastructure using state-of-the-art technology. This strategy continues to be successful as the company has doubled the number of its paid subscribers every year since inception and in the fourth quarter of 2008 bracNet recorded EBITDA profit. Even in the recessionary environment of 2009, the company has continued to increase subscribers.

Another unique feature of the bracNet business model is its corporate structure and allocation of a portion of profits to public-interest initiatives (Chart 2). bracNet was set up as a joint venture between DEFTA Partners and BRAC, the world's largest NGO. It is bracNet's joint venture structure and collaboration with an NGO that allow for a larger portion of the profits to be used for the public interest. If bracNet was just a corporation with solely corporate investors, half of its profits would go toward corporate tax commitments and 80% of the remaining half would be paid out as dividends to investors, leaving only around 10%. Since the maximum allocation for CSR activities is around 25% of retained earnings after tax and dividends, when all said and done, the portion of profits available for community projects and public interest-related initiatives would amount to a measly 2.0%. However, in the case of bracNet, DEFTA Partners has a 60% ownership interest in the company and BRAC, holds 40%. As a result of this ownership structure, 40% of profits can be distributed to BRAC, and since BRAC is an NGO with no shareholders, the entire amount of its portion of distributed profits can be used to fund public-interest initiatives. Last year, the World Bank introduced the bracNet business model in a June 2008 publication for its potential to promote development and improve the standard of living in Bangladesh.

bracNet is focused on long-term profitability and expansion of its network beyond urban areas. A majority of ISPs in Bangladesh are only targeting metropolitan areas since they believe that network expansion into rural areas is not cost-effective. This is already creating an information gap and digital divide domestically. I believe that bracNet will ultimately be successful and more profitable over the

long term by covering the entire country, including rural areas. Rather than simply fighting with competitors over metropolitan areas that are profitable in the short term, bracNet can kill two birds with one stone by expanding into rural areas to increase our subscriber market and at the same time bringing the benefits of Internet communication to these communities. This strategy will bring value to our stakeholders and lead to long-term profitability for bracNet's shareholders. Moreover, the employees of bracNet understand that their work directly correlates to improving the lives of all residents in their community. This understanding has heightened their motivation to work hard and support the success of the business.

Additional Activities in Developing Countries

In addition to bracNet, I am also involved with a number of other initiatives to improve the standard of living in developing countries. As the chairman of the Board of the Alliance Forum Foundation, I have been working on a handful of projects to support economic independence and sustainable development in developing countries. Economic independence is just one piece of the puzzle, though. Eradicating malnutrition and providing sufficient access to healthcare and education for those living in the developing world are also extremely important. To address malnutrition in Africa I am currently helping to promote the production and distribution of Spirulina, a species of microalgae for consumption that is high in protein. To address healthcare and education, I have started telemedicine and distance learning projects that deploy a state-of-the-art video compression technology called XVD.

Unfortunately, with employment in many developing countries at seriously low levels, even those who are healthy and educated often cannot find work. Providing uncollateralized loans to poor but promising entrepreneurs through microfinance can help these individuals start businesses and create opportunities. For this reason, I became highly interested in this arena and began looking for ways to support the global expansion of microfinance.

In this process, I came up with the idea of developing a course for those who aspire to be microfinance professionals. Based on this vision, the Alliance Forum Foundation Development Program (AFDP) has created the AFDP Microfinance Banker Institute which will cooperate with BRAC University to develop top-notch microfinance professionals in the likeness of Dr. Fazle Hasan Abed, the founder of BRAC, and Dr. Muhammad Yunus, founder and managing director of Grameen Bank. This year, we launched a two-week pilot Microfinance Professional Certificate Course. By 2010, we hope to develop a Diploma Course and by 2011 we would like to launch a Master's Program for microfinance professionals. As part of the curriculum, participants will also develop a strong grasp of Public Interest Capitalism as well as receive in-depth training in the use of technology that will enable them to be effective microfinance professionals. The training will also ensure that these professionals can support the development of new self-sufficient industries that can help to build a strong middle class in developing countries.

Microfinance, in which the fiduciary relationship between a lender and a borrower is rooted in personal knowledge of each other or an

Photo: Alliance Forum Foundation



A group of women participating in a microfinance meeting with their peers

actual relationship, is the antithesis to CDO (collateralized debt obligations) based on financial engineering. In this way, the foundations of microfinance compliment Public Interest Capitalism in which finance acts as support for industry, instead of the other way around. Going forward, I hope to combine the power of microfinance with my experience nurturing leading-edge technology start-ups at DEFTA Partners to establish new businesses like bracNet that can contribute to sustainable development in developing countries. If the principles of Public Interest Capitalism can spread via microfinance, I am positive that many healthy industries can be nurtured locally in the developing world.

I will continue in my work to promote the benefits of Public Interest Capitalism-based management across the world. Spreading Public Interest Capitalism-influenced management with its emphasis on creating value for all stakeholders will contribute to the sustainable growth of developing countries such as Bangladesh. With the spread of microfinance, we can also make a tremendous contribution by helping to create businesses that lift citizens out of poverty.

Through our cooperation with hard-working young economists, I am also convinced that we can challenge the validity of shareholder-centric capitalism through theory and experimental research grounded in econometrics and mathematics, and develop a new understanding of economics and capitalism to spread around the world. Public Interest Capitalism encourages long-term corporate investment and management, and facilitates economic stability and a burgeoning middle class. It is precisely this new form of capitalism which is needed for the evolution of society and development of a new era. It is my further hope that Japan and the developing world will be at the center of this evolution by providing real examples and new theories to help steer the world in a new direction that can enrich the life of everyone across the globe. **J.S**

Ambassador George Hara is the Group Chairman/CEO of DEFTA Partners. He also serves as Chairman of the Board for the Alliance Forum Foundation; Prime Minister's Special Commissioner on Government Tax Panel; a Counselor to the Ministry of Finance; and a Counselor to the Minister of Internal Affairs & Communications. Hara is a former Ambassador Extraordinary and Plenipotentiary of IIMSAM to the United Nations Economic and Social Council.