Faith, Flourishing & Finance

By Dean Martijn Cremers

Photography by Barbara Johnston
Illustrations by Taylor Packet

Martijn Cremers came to Notre Dame with his family in 2012 out of a desire to integrate his Catholic faith with serving as a faculty member. Now as the Martin J. Gillen Dean, Cremers' vision for Mendoza centers on his conviction that faith is a critical element to help finance contribute to human flourishing.

When the global financial crisis began in 2007, I was an associate professor of finance at the Yale School of Management. In some sense, I had a front-row seat to observe the crisis. On many days, I had lunch with colleagues who were some of the top scholars on the economy and financial institutions. We discussed topics such as shadow banking, the repo market, mortgage derivatives and other technical aspects of the markets that, from a finance perspective, shed a great deal of light on the underpinnings of the crisis.

As the economic dominoes began to fall — the collapse of the subprime mortgage industry, the failure of Lehman Brothers and other financial institutions, the disastrous spate of foreclosures and massive corporate layoffs — those conversations helped me understand the magnitude of the power of the finance industry to destroy as well as build lives. More personally, the crisis spurred in me an interest to re-evaluate the role of finance in society.

In my arguably sheltered view, the consequences of the crisis did not seem proportionally distributed, hitting hardest some of the most vulnerable people in society, who lost jobs, homes and feelings of worth and security. I began to question who was responsible and, more specifically, what responsibilities did finance have. In my mind at the time, the academy did not seem to have clear answers. Or at least, I did not have answers.

So began my efforts to study how finance contributes to human flourishing, which in turn led to a deeper conviction that faith is an essential compass. Put another way: Faith helps us to see more clearly the intrinsic dignity of everyone affected by financial decisions and to see that everyone in finance has a responsibility to ensure that others — especially those with the greatest needs — also benefit, such that finance truly contributes to human flourishing.

The integration of faith, flourishing and finance is central to my vision as a finance academic and informs my broader vision of business education as the dean of Mendoza College of Business.

In this article, I will share my personal reflections on such a synthesis, particularly as applied to my own area of research, as well as the larger question of how financial markets can contribute to human flourishing. I will focus on the challenge between the commitment to the well-being of all stakeholders necessary for long-term cooperation and the practice of finance in competitive markets that may limit or even undermine such commitment. I will present my view of how faith can help those making financial decisions to see and commit to their responsibilities to help others.

I'll start with my own personal journey to integrate faith and finance, which led me to Notre Dame.

HEART AND MIND

As a cradle Catholic growing up in the small town of Boxmeer in the south of an aggressively secular Netherlands, my faith was not just underdeveloped — it was thoroughly confused (despite the best efforts of my parents). When I completed my undergraduate studies in math, statistics and econometrics in Amsterdam, my Catholic view was not a central part of my life.

That changed when my wife, Liesbeth, whom I met as a college sophomore in Amsterdam, and I were both graduate students in New York City, where we encountered many other students who practiced their faith. Listening to them, I realized I knew very little and understood even less of the Catholic faith. We joined a community of Catholic graduate students on NYU's campus, which helped develop my own faith, along with reading (and re-reading and re- re-reading) authors such as C.S. Lewis, G.K. Chesterton, Henri Nouwen and Peter Kreeft, and later on papal encyclicals such as Pope St. John Paul II's 1991 "Centesimus Annus" and Pope Benedict XVI's 2009 "Caritas in Veritate."

When I had spent almost a decade at Yale, exploring the integration of my Catholic faith and my work as a finance professor was increasingly exciting and important to me. It became one of the key reasons Liesbeth and I decided to come to Notre Dame with our (then) five children (we have six now). We were also drawn to the University's strong sense of collegiality and community, its focus on family and its commitment to academic excellence defined comprehensively: with an educational focus on the formation of the whole person.

To me, these three reasons are interrelated, as any interdisciplinary exploration requires a community of scholars pursuing the synthesis of truth, goodness and beauty (with some shared sense thereof). Likewise, the Catholic understanding of human flourishing is characterized by integral human development, where material, social and spiritual flourishing are jointly pursued and not separated. When we arrived in South Bend in 2012, I did not have a good sense of what such integration would actually look like. Three activities helped develop my thinking about the integration of faith, flourishing and finance.

Listening to them, I realized I knew very little and understood even less of the Catholic faith.

First, each fall semester, I audited a philosophy or theology class taught by fantastic Notre Dame faculty members including Fred Freddoso, David Solomon, Cyril O'Regan and David Fagerberg. Second, I engaged with diverse scholars by attending events both on campus (who knew that football tailgates and basketball games are great places to talk about Catholic social thought?) and off, such as with the Lumen Christi Institute at the University of Chicago.

Third, I started teaching a class on business in light of Catholic social thought to senior undergraduates majoring in finance. We explored issues such as what the social encyclicals teach about the contribution of business to society, and how the catholic "common good" perspective compares and contrasts with the investor or "Wall Street" perspective as well as with that of the stakeholder or "Main Street" view. These three activities combined helped me develop my understanding of the purpose, priorities and practice of business — and finance in particular — in light of Catholic Social Teaching (CST).

THE GREAT WAVE

If you visit my office, one of the first things you will see is a copy of the famous Japanese print "Under the Wave off Kanagawa." The print depicts the eponymous great wave, with Mount Fuji rising in the background and three small rowboats in the foreground trying to cross the stormy seas. The wave symbolizes the challenging, dynamic and competitive nature of business. Like business, great waves offer both danger and adventure. The challenge of staying afloat in such an environment can bring out the best in us. It also raises the question: When the waves are that high, how do we know whether we are going in the right direction?

In stormy waters and with currents that are hard to predict, you need a compass to provide direction — something outside of yourself and independent of these waves. In the print, that compass is represented by Mount Fuji rising above the waters. For Catholics, the compass is Jesus Christ, starting with his Gospel and our relationship with him through prayer and the sacraments as well as by the teachings of the Church and the examples of the saints.

As applied to business or finance, the Church's social teachings are mostly "catholic" with a small "c," based on universal principles that anyone can accept. The three most important, and closely connected, social principles are:

1. The intrinsic, infinite dignity of our shared human nature, which is inherently social, where each person is always a person-in-community and essentially relational.
2. Solidarity, or the willingness to share priorities, to make the needs of others your own priority.
3. The shared practice of subsidiarity toward integral human development.

Each of these three social principles is required for the fleet of ships — the third element of the print — to successfully arrive at a common destination. I'm borrowing here the analogy of the fleet of ships from C.S. Lewis' masterpiece of Christian apologetics, "Mere Christianity." In this book, the author uses a fleet of ships to explain the inherently social nature of morality. The individuals in the ships must recognize that together they constitute a fleet with a common destination (shared purpose). Collectively, the ships also must have good relationships and assist each other as needed (shared priorities). And third, each ship must strive to be at its best, which requires teamwork or the give-and-take of the help of others (shared practice).

These three aspects — shared purpose, shared priorities and shared practice — are closely connected. Why would you be willing to make someone else's priorities your own? A good reason to do so is the recognition that you have a shared purpose, which can be as simple as seeing our shared human nature or one another's intrinsic dignity. Similarly, you see that all of the gifts you have received are given to you to be shared with others and are best developed in cooperation with others.

The social environment where each person can grow toward the best version of themselves is characterized by subsidiarity, which comes from the Latin word subsidium, meaning support or assistance. Subsidiarity indicates the shared practice of people helping each other to develop with respect for each person's freedom.

Let's apply the three social principles to business using the analogy of the fleet of ships: The shared purpose of business is to contribute to human flourishing; the shared priority is to cooperate well with all stakeholders in solidarity; and the shared practice of business is to compete in the marketplace with excellence, through providing a social environment in which each person can grow (or compete internally) toward the best version of themselves in subsidiarity.

I refer to these concepts as the three C's: contribute, cooperate and compete. Business contributes to human flourishing through the goods and services that provide for the actual needs of people and improve livelihoods; through the interpersonal, cooperative relationships that arise among all of the stakeholders; and through effective competition in both the external marketplace and internally toward material, social and moral excellence.

Faith can help us see these three social principles more clearly by purifying our reasoning, judgment and manner of action. Faith teaches us that we are all made in the "image and likeness of God," and our dignity is intrinsic rather than coming from our accomplishments. Because of this, faith helps us recognize the disproportionate obligation — disproportionate in the sense that we have responsibilities to others who cannot help us or give back — that we treat everyone with respect and justice. This means actively working toward greater diversity and inclusion irrespective of whether the other person is useful to us in any way.

It's thus disproportionate as we should not cheat or take advantage of others even if that could make us rich. Faith reveals that the essence of God is love, and the essence of our human nature is to receive and respond to God's love by loving God and others and all of God's creation. We cannot separate our flourishing from the flourishing of those around us. Faith helps us to see the difficult truth that we are all in need of help from God and others, help we can then pass on to others in subsidiarity. As Pope Francis wrote in "Laudato Si'," "everything in the world is connected." He argues that "human life is grounded in three fundamental and closely intertwined relationships: with God, our neighbor, and with the earth itself."

"Under the Wave off Kanagawa," also known as "The Great Wave," from the series Thirty-six Views of Mount Fuji, Katsushika Hokusai, ca. 1830–32.

WHAT ABOUT FINANCE?

Let's return to the analogy of the fleet of ships in the "Great Wave." If the shared purpose of business is to contribute to human flourishing, the shared priority is to cooperate well with all stakeholders in solidarity, and the shared practice of business is to compete in the marketplace with excellence, then where does finance fit in?

Let's start with a quick summary of the three main functions of finance: 1) allocating financial resources; 2) connecting parties (such as borrowers with savers) through markets, securities and contracts; and 3) providing information about which business decisions create financial value (i.e., providing rewards given the risks).

Finance performs these functions well when financial resources go to where the most productive opportunities are; when everyone affected by financial decisions benefits; and when market prices provide the best summary of all publicly available information that everyone can learn from. In general, the three functions of finance and the benefits they bring support and reinforce each other. For example, allocating financial resources toward those with the best opportunities is easier if market prices provide better information about where those opportunities are.

The primary mechanism through which finance provides these benefits is through the process of competition in some kind of a market. Three inherent aspects of market competition are 1) bargaining with others with conflicting short-term goals rather than coordinating with others toward a shared purpose, 2) getting transactions done rather than building a longer-term relationship, and 3) the availability of substitutes. Each of these three aspects of market competition contrasts with the centrality of cooperation in the vision of business sketched above.

The ideas of commitment and coordination are central to cooperation, but antithetical to efficient competition.

I am focusing on the contrast between cooperation and competition here because I think it presents an important challenge for finance and academic research. In the competitive environment of a market, transactions mainly takes place through "adversarial" bargaining. To illustrate, consider what happens when you buy a cup of coffee from one of a number of available coffee shops. The transaction is adversarial in the sense that the less you pay, the better it is for you and the worse it is for the coffee shop. When competition is efficient, both you and the coffee shop agree on the price, and both sides benefit. And in an efficient market, there are close substitutes available so that it is easy to go elsewhere, which gives an incentive to the coffee shop to treat customers well and keep prices reasonable.

The notion of cooperation presents a different scenario. Here, the focus is on working together toward a shared goal, where what team members receive and give may greatly differ. It is the difference between a single ship charting its own course and a fleet of ships moving toward a common destination with an ex-ante or predetermined commitment to coordinate with and take care of each other.

The ideas of commitment and coordination are central to cooperation but antithetical to efficient competition. If you are competing, you do not commit to anything beyond what you are bargaining about, and the central coordination mechanism in markets is the "invisible hand" of the price. By contrast, cooperation generally requires some kind of hierarchy that facilitates coordination within the team toward a shared purpose and requires some kind of commitment to a longer-term relationship that is more open-ended.

As a result, competition only requires trusting that the other side will hold up its end of a particular bargain. However, cooperation requires a much deeper trust that the team you join has goals that are aligned with yours; further, that the team is committed to your flourishing *for your own sake*. Joining any team requires some specific commitment on your part, such as moving to where the team is located and learning the unique way the team works together. More generally, cooperation requires your willingness to become dependent on your teammates rather than only on yourself, as well as your willingness to help your teammates and jointly strive toward some shared goal.

Changing the analogy from a fleet of ships to playing basketball: You compete against the other team but cooperate with your team members. Because of my children, I've watched a lot of middle and high school basketball. When the kids first learn to play, they all want to shoot regardless of position. It's tough to get them to pass. But as they get better at the game, they learn to cooperate with each other and focus on scoring points as a team, and how their individual task needs to serve the team. This requires the players to cooperate with their teammates, rather than compete individually for the ball.

The complexity and challenge of business are that the fundamentally different mechanisms of cooperation and competition exist side by side. In the "Great Wave" print, the water symbolizes the competitive environment of business while the boats symbolize the cooperative nature of business. In each business, stakeholders are cooperating to generate the goods and services that the firm sells within some competitive marketplace. More generally, corporations participate in product, labor and financial markets, which themselves depend on institutions that are social, cooperative organizations.

To summarize, competition is characterized by bargaining in markets, conducting independent transactions and having close alternatives or substitutes available. Each of these elements implies a strong ability to exit or to go elsewhere if you have better options available. The stronger your ability to exit, the less likely you are to be committed to cooperate when circumstances change. The challenge is that the different stakeholders of a typical publicly traded firm typically have very different abilities to exit. I would argue that shareholders generally have the strongest ability to exit, the implications of which for finance are discussed below.

STAKEHOLDERS VERSUS SHAREHOLDERS

In my academic research (see "Additional Resources" list on page 29), my co-authors and I explore the interaction between the need for commitment to a longer-term corporate strategy and the market provided by a competitive market. In particular, we argue that among all of the stakeholders of a typical, large, publicly traded corporation, the well-diversified and large shareholders (usually institutions such as banks and investment companies) are the least committed to the long-term strategy, simply because they can always exit. There are several ways for public shareholders to do so, including selling their shares in the open market, voting for an acquisition or buyout, or supporting activist investors, such as hedge funds, through proxy voting.

The very ease with which public shareholders can exit is a central feature of competitive markets, one which focuses corporate management on delivering financial results in line with the market's expectations. However, a great ease of exit (or very competitive financial markets) also means that shareholders of public companies can effectively pressure corporate boards and management to change the corporate strategy without giving much notice.

The shareholder primacy view does not strike the right balance between market competition and stakeholder cooperation, in my view.

Other stakeholders such as employees, customers, suppliers and the communities in which they reside cannot so easily change their relationship with the firm. This asymmetry in dependency is not inherently problematic, and market competition comes with many benefits. Yet an environment where financial stakeholders have strong exit rights or too little commitment to the long-term strategy of the firm may limit the ability or increase the costs of the other stakeholders to cooperate. And the strong joint commitment necessary for good cooperation among all of the corporate stakeholders is not only economically but also morally important.

Such commitment matters *economically*, especially if certain stakeholder groups — such as top employees, large customers and suppliers — are to make firm-specific long-term investments in their relationship to the firm; for example, through investments in the firm's unique technology. Without a joint commitment, these stakeholders will be more reluctant to commit to such long-term investments that stand to lose economic value if the corporate strategy changes.

A longer-term commitment to the shared flourishing of all stakeholders is particularly important *morally* when the stakeholders who are the most vulnerable to any short-term changes in the firm's strategy are those with the least protection against disruption or have the fewest alternative opportunities. Without such a commitment, the cost of disruptions to the corporate strategy are likely to fall disproportionally on the most vulnerable stakeholders, perhaps even to the benefit of the least vulnerable stakeholders. An example would be a significant increase of the leverage of the company by borrowing a lot more money and paying out a lot more in cash payments to shareholders — which often (disproportionally) benefits shareholders but not (or even comes at the expense of) the other stakeholders such as employees by increasing risk.

In other words, if investors have too much power to change the corporate strategy even over short-term horizons, this may limit the ability of the firm to create economic value — like executing a long-term strategy with investments in research and development — and may lead to immoral transfers of wealth from less to more powerful stakeholders. On the other hand, if investors have too little power, the firm will have difficulty attracting capital, especially for long-term projects, also limiting economic value creation and the firm's contributions to human flourishing, which constitutes the moral purpose of business.

This discussion is closely related to the "Statement of Purpose of a Corporation" recently issued by the Business Roundtable that redefined the purpose of a corporation to promote "an economy that serves all Americans." Signed by 181 CEOs of major corporations, the new statement in particular moves away from "shareholder primacy" to include a commitment to all stakeholders — customers, employees, suppliers, communities and shareholders. This shift recognizes that the shareholder primacy view does not strike the right balance between market competition and stakeholder cooperation, in my view. Further, it's an important indication that many corporate leaders understand the importance of being committed to good cooperation with all stakeholders.

LONG-TERM COMMITMENT

Signing such a statement is one thing. The real issue becomes how to follow through and generate value for long-term investors but not focus on short-term financial performance while also warding off aggressive speculators looking for a quick profit. The primary answer, I suggest, is that both corporations and investors need "commitment devices" that bind them toward longer-term cooperation and limit their ability to make changes in the short-term, while preserving their flexibility to change the strategy over longer periods through a process that involves the other stakeholders.

A key example of such a commitment device is a staggered board, where corporate directors serve overlapping three-year terms, so that every year, only one-third of directors are up for reelection rather than the full board (as is the case for the majority of firms incorporated in the U.S.). While staggered boards limit the ability of shareholders to rapidly change who is on the board of directors, they also allow directors to focus on the longer term and commit themselves to good cooperation with all stakeholders. At the same time, the shareholders retain their ability to change corporate boards over the medium term, as a majority of directors can be changed over two consecutive annual director elections, and thus keep their disciplinary role.

Our research findings suggest that staggered boards are strongly associated with improved corporate performance over the long term, such that shareholders benefit from committing to a longer-term focus. The findings support the larger idea that committing to cooperation and limiting their power can actually create more financial value for shareholders themselves.

"Directors' duties" state laws are another example of how finance vis-à-vis shareholders can commit to the flourishing of all stakeholders. These are state statutes (also called "stakeholder state laws") that allow corporate directors to consider the interests of all stakeholders, rather than only of the shareholders, when making major decisions. State laws apply to all corporations incorporated in the state where they are adopted. Many states — with the exception of Delaware, where most large public corporations are incorporated — have adopted a stakeholder law. They enable directors to have a stakeholder orientation and allow directors more freedom to consider the interests of all stakeholders when making strategic decisions, rather than primarily focusing on the interests of shareholders.

Our recent research paper explores how the stakeholder orientation allowed by these state statutes relates to firm performance. We find that corporate valuations and profitability *improved* for firms after the state in which they are incorporated adopted a stakeholder law, especially if these firms were more engaged in long-term investments and research and development or had more important stakeholder relationships. Similar to our results for staggered boards, these findings are consistent with the idea that these state laws encourage a stronger commitment of the corporate board to cooperate with all stakeholders *to the benefit of shareholders* (even if these laws also complicate the short-term performance evaluation of executives and the board).

The paradox here is that committing to the other stakeholders can actually benefit shareholders themselves. However, binding yourself to others, committing to a shared purpose and rendering your flourishing dependent on the flourishing of others, is not easy. This requires a cooperative rather than competitive attitude, increased trust, and recognition of mutual and interdependent needs. If you are powerful, have better information and lots of opportunity to exit, it seems easier to depend on competition rather than cooperation to achieve your objectives. If you are working in a financial market environment, it may be easier to think primarily in terms of competitive transactions, substitutes and individual incentives, like the standard finance textbook still does, and think of true cooperation as naive.

The perspective of faith, I submit, can help us see the primacy of cooperation: that we need the help of others, have responsibilities to others, and that our flourishing is fundamentally interdependent with that of others. Therefore, it is good for us to commit to the well-being of others, as we cannot separate our own flourishing — economically, socially and morally — with the flourishing of everyone around us.

The findings support the larger idea that committing to cooperation and limiting their power can actually create more financial value for shareholders themselves.

MORAL IMPERATIVE

On Sept. 29, 2008, the Dow Jones Industrial Average dropped 777.68 points in one day to close at 10,365.45. Home prices fell by more than 30% that year and unemployment hovered over 9%. Today as I write this, the Dow Jones is around 27,000 and the jobless rate is about 3.7%.

The creation of long-term value for all stakeholders is indeed the moral imperative, with a particular emphasis on those with the greatest needs or the fewest opportunities.

Yet since the end of the global financial crisis, income and wealth inequalities have increased further, as have political and social discord. It thus remains pressing to consider how finance and the economy can be reformed to better contribute to human flourishing for everyone. Our current business students, at Mendoza and elsewhere, are strongly interested in the positive social impact that business can and must have. The new statement on corporate purpose from the Business Roundtable is also consistent with a stakeholder orientation that moves away from a narrower shareholder value view.

In the previous paragraphs, I've outlined a vision of Catholic social thought as it pertains to business in general and the finance industry more specifically. As I have argued, the creation of long-term value for all stakeholders is indeed the moral imperative, with a particular emphasis on those with the greatest needs or the fewest opportunities.

Economically, creating long-term value requires businesses to collaborate fruitfully with all stakeholders, and in turn that long-term cooperation requires a real ex-ante commitment, especially from finance or investors. Due to the inherent differences between market competition and cooperation with stakeholders (let alone solidarity with those without any seat at the table), financial market participants need to commit to their responsibilities to the other stakeholders.

The main challenge that I leave us with is how to help market participants, our students and ourselves see the shared purpose and need for cooperation so that we consider the broader negative impact of exiting markets and pursuing purely short-term gains. Otherwise, competition may crowd out social capital or trust among stakeholders, cooperation becomes more difficult, and both the economic and social values of business are curtailed.

This point is made much better (and more theologically) by Pope Benedict XVI in his 2009 encyclical titled "Caritas in Veritate" (Charity in Truth). In paragraph 39 of this encyclical, he distinguishes between three different logics or ways of thinking: the logic of the market competition, the logic of the state and the logic of reciprocal gift. The logic of market competition is that of "giving in order to acquire," and that of the state is "giving through duty." In contrast, the logic of reciprocal gift is the logic of cooperation, or of giving out of gratuitousness and communion.

Cooperation requires one to see the shared purpose (i.e., common good or communion) and a willingness to ex-ante (and thus gratuitously) commit to the well-being of others. Such gratuitousness makes room for solidarity and affirms the inherent dignity of everyone involved or affected by business. This gratuitousness depends on and requires trust and faith in each other.

The ultimate source of such gratuitousness is the free gift of faith in the Triune God Who is the Giver of all gifts, Who cannot be out-given, Who invites us to respond to His gifts with generosity on our part, and in, through and with in Whom we all have our common origin and our common destination. **M**

ADDITIONAL RESOURCES

"Staggered Boards and Long-Term Firm Value, Revisited," Martijn Cremers, Lubomir Litov and Simone Sepe; Journal of Financial Economics (2017)

"The Shareholder Value of Empowered Boards," Martijn Cremers and Simone Sepe; Stanford Law Review (2016)

"Commitment and Entrenchment in Corporate Governance," Martijn Cremers, Saura Masconale and Simone Sepe; Northwestern Law Review (2016)