Measuring Purpose – An Integrated Framework

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1. Introduction

The last few years have witnessed a rapid growth of interest and concern about the purpose of business, how it relates to its shareholders and stakeholders, the boundaries of the firm, the resources that are required to manage firm activities, and the impacts firms have on other parties. This has prompted numerous initiatives to identify data and measurement systems that allow companies to align their practices with their purposes, establish their dependence, exposure and impact on their shareholders and stakeholders, and evaluate the overall effects of their activities. The problem that has arisen has been not so much a shortage but, if anything, an overabundance of initiatives that are often confusing to interpret, costly for firms to implement, and inconsistent in their assessments. In addition, in searching for an ever wider set of approaches, simplicity has been sacrificed for complexity, making dissemination and discussion beyond expert groups almost impossible.

There are many parties who should be served by measurement – not least employees, customers, suppliers and civil society - but there are four who are particularly relevant to the delivery of corporate purposes. The first is the executives of companies who formulate strategies, allocate resources, and incentivize people in their organizations on the back of measures of performance. The second is middle management who make investment decisions, implement projects and deliver performance within their organizations. The third is institutional investors who make portfolio allocations, monitor investments and steward the companies in which they invest. The fourth is policy makers who seek to align corporate behaviour with public interest and promote public investments, frequently in partnership with the private sector. A system of measurement must serve the needs of at least these four parties if business and economies are to operate effectively.

Traditional methods of corporate performance measurement fail to account for the emerging phenomenon of purpose-based belief systems and managerial practices. They are based on a legal concept of a firm as an entity that owns property and contracts with other parties. They record costs, incomes, assets and liabilities associated with these activities, and make provisions for maintaining physical assets and servicing liabilities. They report the actual costs of the resources that a firm employs and the earnings that it derives from them, distinguishing current costs from capital expenditures.

What accounts do not currently record are the costs of maintaining assets that a firm does not own but on which it depends, or the liabilities for which it is not contractually or legally obligated but nevertheless responsible because of its impacts on other parties. In its current form, accounting serves the purpose for which it is designed of being aligned with a property right but not a responsible owner or purposeful management view of the firm. As a result, accounts currently do not provide all the information that is relevant to promoting responsible, purposeful business practices because, against that benchmark, profit is overstated where companies cause detriments to other parties and not fully recognized where they confer benefits.[1]

The aim of this paper is to clarify the confusion that arises in the context of how to measure performance in relation to purposeful business practice by putting forward a clear approach to measurement, drawing on real world management practices, comparing the different approaches that are being taken, and proposing a model that allows for better informed decision-making. We argue for a three-step internal model to reporting, which falls to the organisation to undertake and which enables a set of relevant appraisals both by senior management teams and also by external stakeholders, including investors and policymakers.

2. The Three-Step Measurement Model

In recent years, boards of directors have become increasingly focused on corporate purpose. This is partly driven by a sense that purpose drives corporate culture, helps attract and retain talent, and is increasingly a differentiator when it comes to customers and suppliers. External pressure on boards to define purpose better has come from investors, who are themselves being asked to justify their own investments on the basis of environmental, social and governance (ESG) as well as financial considerations, and regulators, who are tasked with oversight in multiple different sectors.

This combination of pressure points has focused attention on how purpose can be measured. To date, the general approach has focused on two largely disconnected considerations: first, articulating purpose as a set of intents, values or desired behaviours and outcomes, and second, measuring and monetizing the impacts of company activities. These considerations have been subject to claims of imprecision on causality, and vagueness in determining monetary impacts.

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[1] EU Regulation on sustainability-related disclosures in the financial sector recognizes the need for no-harm performance measurement. (EU) 2019/2088 states in section (17) that "it is necessary to lay down a harmonised definition of 'sustainable investment' which provides that the investee companies follow good governance practices and the precautionary principle of 'do no significant harm' is ensured, so that neither the environmental nor the social objective is significantly harmed." See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2088.

To address these concerns, we propose the adoption of a three-step measurement model, as set out in Figure 1 below, which aligns measurement of business impacts with the strategic motives of an organization and monetization through two distinct but complementary methodologies.

Figure 1: Motives, Metrics & Money

Step 1: Motives	Step 2: Metrics	Step 3: Money
Purpose (why the company exists)	Inputs (what the company uses)	Enterprise Cost-Based Approach
Mission (what is its strategy)	Outputs (what it produces)	Societal Valuation-Based Approach
Vision (where it aspires to be)	Outcomes (what changes)	
Values (how it operates)	Impacts (effects on well-being)	

2.1 Motives. The first stage in the three-step model is to set out corporate motives, as expressed through stated purpose, mission, vision and values. Together these represent an expression of the motivation of the organisation and the core organising principles for corporate resource allocation. The Enacting Purpose Initiative ('EPI') suggests that boards should:

- Define their purpose: articulate why the organisation exists.
- Establish their mission: set corporate strategy, what the organisation intends to do.
- Determine their vision: where the company aspires to arrive.
- Implement their values: the principles that underpin how the company is governed.[2]

We suggest following the EPI by using the British Academy Future of the Corporation program[3] definition of corporate purpose as being about "producing profitable solutions for problems of people and planet, not profiting from producing problems for either". This focuses business purpose on problem solving, identifying commercially viable, financially profitable and sustainable solutions, and the avoidance of detriments. Motives provide the lens through which materiality is defined and metrics are measured.

[2] The EPI describes a 'SCORE' framework for establishing effective governance of corporate purpose.

[3] https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/

2.2 Metrics. The second step is to identify the business metrics that are required to enact purpose. This relates to four critical areas as follows:

- Inputs: the human, social, natural, physical and financial resources which a company uses in its activities.
- Outputs: a measure of what a company produces.
- Outcomes: changes brought about by a company's activities.
- Impacts: consequential effects on the well-being of others, e.g. customers, employees, suppliers, societies and the environment.

When compiling reports in relation to their purposes, companies provide qualitative, quantitative, financial and non-financial information. The information is of relevance to (current and future) shareholders, and in evaluating a company's effects on its stakeholders. It is therefore appropriate that there are different types of reports and accounts, some relating to the financial performance of the firm and others to its wider impact.

There are certain forms of reporting against which it might be expected that all companies should establish metrics and some that are common to all companies in a particular sector or industry. For example, the significance of global warming for our future survival means that all companies might reasonably be expected to report on their carbon emissions. Similarly, concerns about inequality might justify all companies reporting a standardized pay ratio of their top to median incomes, and their commitment to paying a living wage. Concern about tax avoidance by companies might require reporting by companies on their tax payments in different jurisdictions. All these relate to systemic challenges that confront all companies, regardless of their geography and sector. Other issues may only be material to particular industries, such as data security for online platforms or child labour in food and apparel value chains.

So, some forms of general and industry standardization and harmonization might be sought in reporting through, for example, the European Non-Financial Reporting Directive (NFRD)[4] and the creation of a Sustainability Standards Board (IFRS)[5]. However, this should be against the background of reporting being tailored to the purposes of companies and the information needs of their different constituencies.

2.3 Money. The third step in the model is the comprehensive monetisation of the metrics set out in step 2. In this step, monetary values are attached to the metrics. The importance of this derives from the fact that monetary values are the basis on which resource allocations and investment decisions are made by boards of companies and by investors, and by regulators and governments in evaluating the social contributions and detriments of companies.

In the context of corporate purpose, it is as necessary to attach values to human, social and natural capital employed in the delivery and fulfilment of purpose as it is to their material and

[4] EU Directive 2014/95/EU.

[5] https://www.ifrs.org/news-and-events/2020/09/ifrs-foundation-trustees-consult-on-global-approach-to-sustainability-reporting/

financial counterparts. While concerns are sometimes raised about monetary values, especially in relation to nature, on the grounds of "knowing the price of everything but the value of nothing", a failure to do this leads to the more serious problem of not valuing anything that is not priced, and consequently misallocating scarce and valuable resources.

There are two approaches to allocating monetary value. We argue that both should be available to management, boards, investors and policymakers.

- The first of these is *an enterprise cost-based accounting approach,* which looks at monetization from the perspective of the enterprise. Traditional cost-based accounting attaches specific and identifiable financial costs and revenues to inputs and outputs. In the context of corporate purpose, however, cost-based accounting would also need to account for the impacts of a company on financial and non-financial resources. It would record the costs that a company incurs in remedying the detriments it causes and the benefits it generates in relation to the externalities it imposes on other parties.

  In particular, to avoid profiting from causing harm to others[6], a company should track the external costs that its activities impose upon human, social and natural resources, and set these against financial profit in measuring its performance broadly defined. Conversely, if a company invests in assets it owns which confer benefits on other parties that extend over more than one year, it should track these in a way that parallels its treatment of capital expenditure in the balance sheet. In other words, a company's accounting extends beyond financial statements to report costs of maintaining and enhancing human, social and natural resources in the delivery of its purpose, irrespective of whether they fall within or outside the legal boundaries of the firm.

  What the proposed accounting framework therefore does is to extend traditional accounting from the legal boundaries of the firm to its effective boundaries in terms of its outcomes and impacts. It redefines boundaries from legal delineations to relevant operational considerations in relation to delivering a company's purpose and classifying expenditures as current or capital in nature.[7]

[6] This can, for example, address the EU Taxonomy's requirement for a company to record where it causes environmental damage and how it accounts for the principle of "no harm".

[7] It is important to recognize that this is not a proposal to extend accounting to incorporate companies up or down a firm's value chain. It is a content related elaboration of existing accounting methods to record spending on maintaining social and environmental assets on which a company depends and has impact outside as well within its legal boundaries. In the current accounting system, only the maintenance of physical assets is recorded. By expanding to include social and environmental assets, profit net of the costs of remedying harm is reported. Adjusting income this way ensures that profit reflects costs associated with environmental and social assets on which a company depends and has impact. Likewise, a company would account for expenditures on building social and environmental capital as an investment. It would be able to capitalize investments on social and environmental projects, recognizing them as assets, not current expenditures. As with intangible assets (such as brands), investments in key social and natural assets would therefore appear on the balance sheet of a company.

- The second form of reporting is *a societal valuation-based approach* which attempts to establish the impact of a company's activities on society and the environment.[8] Traditional approaches to valuing purpose have focused on one stakeholder audience – shareholders. Where there are relevant goods or services being traded then there are observable prices with which to undertake valuations.

  In the context of purposeful business, valuations should also be determined from a societal and environmental perspective in regard to human, social and natural capital that are material to the delivery of a firm's purposes and strategic operations, as well as those that are physical and financial. By definition therefore, these can be found outside as well as within the legal boundaries of the firm, but only in so far as they are relevant to the ecosystem in which the organisation operates and relate to its corporate purpose and mission.

  In some cases, these valuations can be determined from specific prices, for example the cost of carbon emitted, as reflected in the cost of carbon credits. In others, there are broader approaches to measuring purpose and impact, for example, where there are costs of damage or insurance to compensate for harm that can be used to derive prices.

  Valuations may in addition be determined from present values of predicted future benefits and detriments discounted at appropriate private and social discount rates. Econometric analyses may be undertaken of observable prices from, for example, land values to estimate costs of pollution or flooding, and survey evidence might provide indications of the valuations that people attach to different types of benefits and detriments where actual transaction data are not available.

  What this second approach therefore does is to assemble as much information as possible from costs, prices, projections, statistical analysis and surveys, and apply the most advanced techniques to impute factors for converting metrics into monetary valuations of non-material and non-financial assets and liabilities from a societal perspective. It will then be possible to attach valuation multipliers directly to purposeful activity.

  For example, businesses that act in pro-societal ways might reasonably be expected to have lower political and social risks attached to their activity, therefore attracting higher multipliers on their earnings, and a lower cost of capital. Likewise, businesses that are understood to be well governed and responsible might be expected to benefit from lower costs of capital. Valuations can therefore be made explicit in identifying links to purpose and therefore what multiples are appropriate to particular firms and their activities.

There are three principal benefits from this three-stage approach to measurement and evaluation. The first is that it allows an organisation to capture the financial and non-financial

[8] For further information on valuation in relation to environmental impacts see ISO14008 at https://www.iso.org/obp/ui/#iso:std:iso:14008:ed-1:v1:en

impacts of the full perimeter of its activity. This is relevant to both management decision making and disclosure of the degree to which a company is fulfilling its purpose.

The second is that different stakeholders can undertake their own assessments of the value of the organisation. Investors can assess the quality of the firm as an investment on the basis of a diverse range of numbers. Political and societal leaders can assess the impacts of an organisation on the lives of members of specific communities. Employees can assess commitments made to impacts delivered, attaching value to meaningful work, and suppliers can make their own assessments of levels of commitment to an organisation based on its vision for impact.

The third benefit is that cost-based accounting and valuation answer different questions. Cost-based accounts establish the resources that companies have to expend in correcting detriments and/or generate positive externalities that firms create outside as well as within their legal boundaries, whereas valuations capture the net benefits or detriments of the firm's activities, its outcomes and impacts on its stakeholders as well as its shareholders.

The above framework therefore allows for assessments from the perspective of different stakeholders, reflecting their own perspectives on the firm and its corporate purpose.

3. Towards A Common Framework

A number of excellent initiatives seen in academia and practice around the world can now be classified under the three headings – motives, metrics and money.[9]

3.1 Motives: initiatives include the Enacting Purpose Initiative, the WEF's 'Davos Manifesto' and the British Academy's 'Principles for Purposeful Business'. [10]

3.2 Metrics: while there are still a number of initiatives that seek to define the leading variables driving holistic value creation, approaches of reporting continue to be developed at pace for the major dependency assessments and externality impacts. Some of these cater for investors, some for stakeholders in general and some for particular groups of stakeholders. A few of the most widely cited initiatives are:

- Accounting for Sustainability (A4S) provides a framework for sustainable reporting.
- The Carbon Disclosure Project (CDP) promotes a global environmental disclosure system.
- The Global Reporting Initiative (GRI) is a stakeholder-focused form of reporting.
- The International Integrated Reporting Council (IIRC) sets out a framework for integrating ESG measures relevant to investors with financial information.
- The Sustainability Accounting Standards Board (SASB) focuses on financially material reporting for investors.
- The Task Force on Climate-related Financial Disclosure (TCFD) is concerned with climate related reporting.

[9] The Impact Management Project (IMP) has performed an important role of clarifying the relationship and relevance of these different initiatives.

[10] Important challenges to corporate purpose include Lucian Bebchuk and Roberto Tallarita (2020), 'The Illusory Promise of Stakeholder Governance'. For a response to this paper, see Colin Mayer (2020), 'Shareholderism versus Stakeholderism – a Misconceived Contradiction'. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3617847

- The World Economic Forum (WEF) identifies standardized metrics for reporting on value creation to investors and stakeholders.

Recently, there have been significant developments in promoting metric standardization. The GRI, SASB, IIRC, CDP, and CDSB intention to work together is an example[11]. Another is the merger of SASB and the IIRC into the Value Reporting Foundation[12]. The third is the IFRS consultation[13] on its role in promoting global sustainability reporting and the creation of a Sustainability Standards Board. We welcome all of these developments.

3.3 Money: There are a number of initiatives that are attempting to monetize dependencies and impacts in relation to both cost and fair value accounting:

- Cost accounting: the mutual profit of the Economics of Mutuality[14] and the Rethinking Performance Initiative at the Said Business School, and integrated accounts of the Value Balancing Alliance are initiatives that seek to extend conventional cost accounting to incorporate non-financial resources in a firm's ecosystem.
- Valuation: The impact statements of the Value Balancing Alliance, and the Impact-Weighted Accounts Initiative (IWAI), which is a joint initiative of the Global Steering Group for Impact Investment, the Impact Management Project and Harvard Business School, are analysing and monetising the impacts of companies and establishing a methodology for reflecting these impacts through their financial accounts.

4. Conclusion

We propose in this paper a logical and inclusive model for measuring purpose. We advocate a three-step process the first of which publicly anchors the purpose, mission and vision of the organisation together with clarity around how these are governed. The second step identifies the business impact metrics that flow from the enactment of this stated purpose and mission. This metrics need to capture four items – inputs, outputs, outcomes and impacts. The third stage sees these four reporting items being allocated monetary values through enterprise cost-based accounting and societal valuation where appropriate and relevant.

This three-step model provides a coherent reporting framework against which critical decisions can be made. These decisions may be internal – enabling management to allocate scarce resources better – or external, allowing investors and other critical stakeholders to assess the performance of a company against its stated purpose. We conclude by categorising the different measurement initiatives under the three stages of the model, in the hope that this will promote further discussion and convergence of best practice.

[11] https://impactmanagementproject.com/structured-network/statement-of-intent-to-work-together-towards-comprehensive-corporate-reporting/. IIRC and SASB have also announced plans to merge: https://www.accountingtoday.com/news/iirc-and-sasb-plan-merger-for-next-year

[12] https://www.sasb.org/wp-content/uploads/2020/11/IIRC-SASB-Press-Release-Web-Final.pdf

[13] https://www.ifrs.org/news-and-events/2020/09/ifrs-foundation-trustees-consult-on-global-approach-to-sustainability-reporting/

[14] A programme developed initially by Mars Inc., now the Economics of Mutuality Foundation, and the Said Business School at the University of Oxford, which has sought to clarify the relationship between purpose, inputs, outputs, outcomes and impacts, and the importance of aligning management practices with purposes through appropriate incentive systems.