



ADVISOR 2019 SYMPOSIUM

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The Business Case for Purposeful Business

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I. The Idea



Source: "William C. Campbell, Wikipedia, December 11, 2018.

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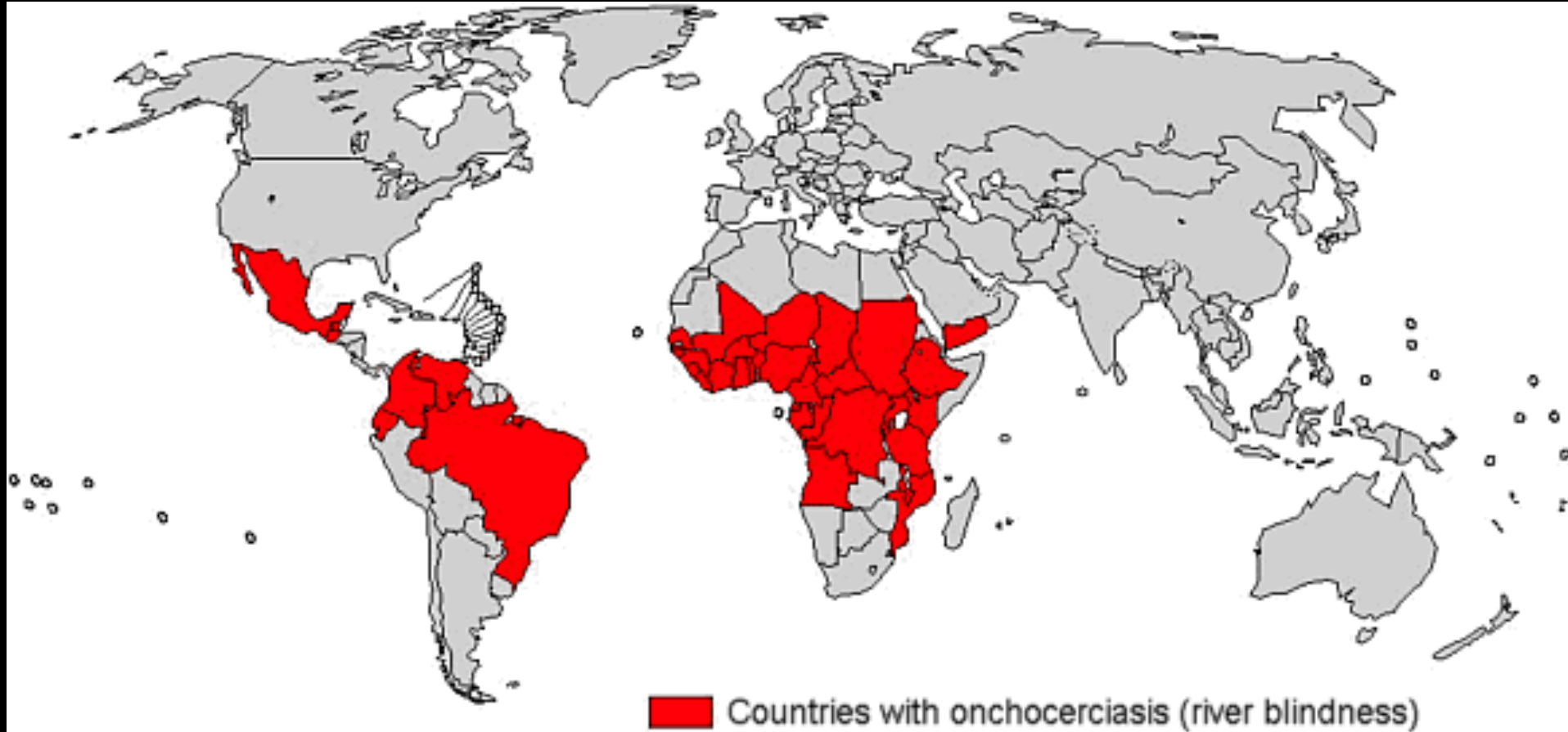
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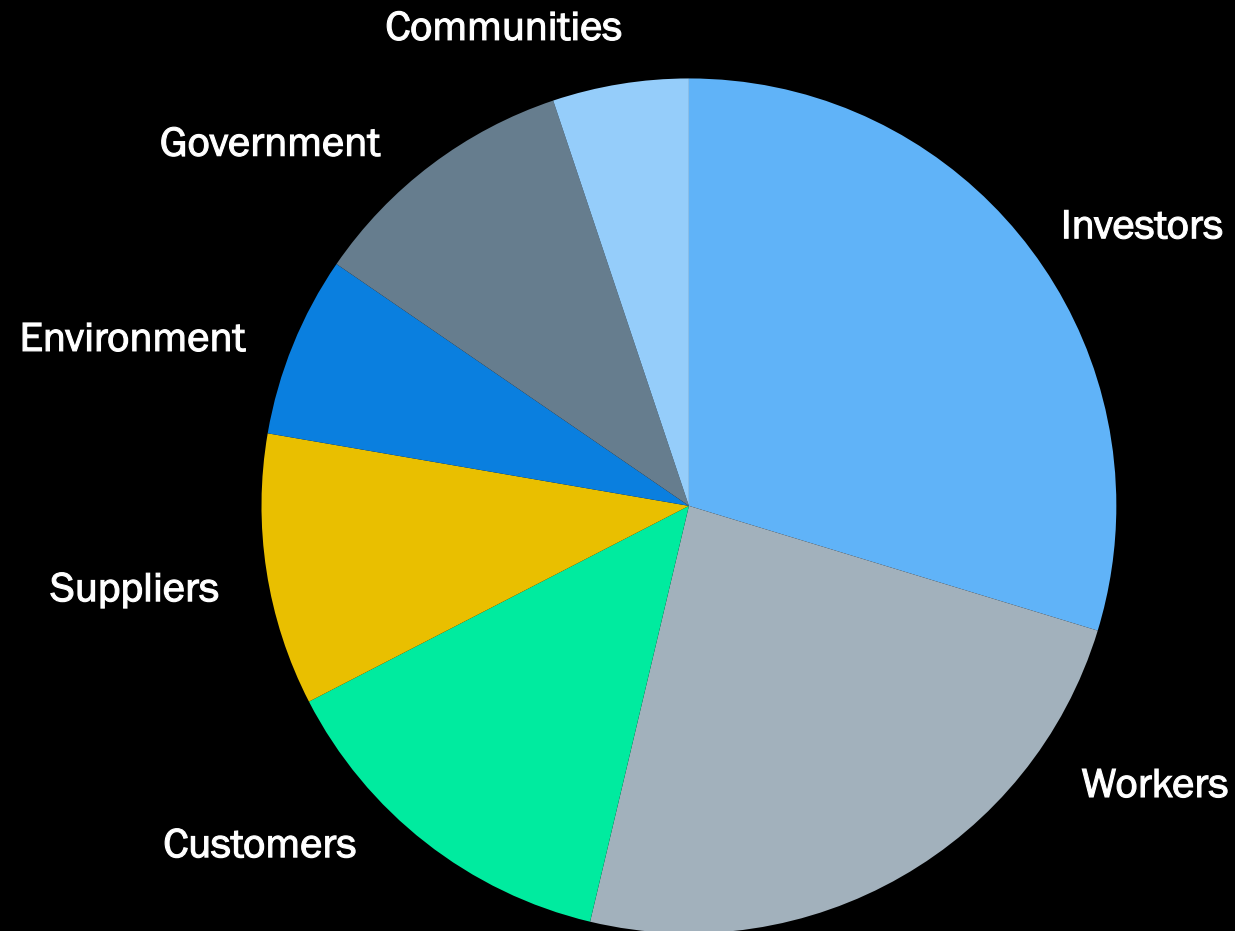
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Mectizan Donation Program

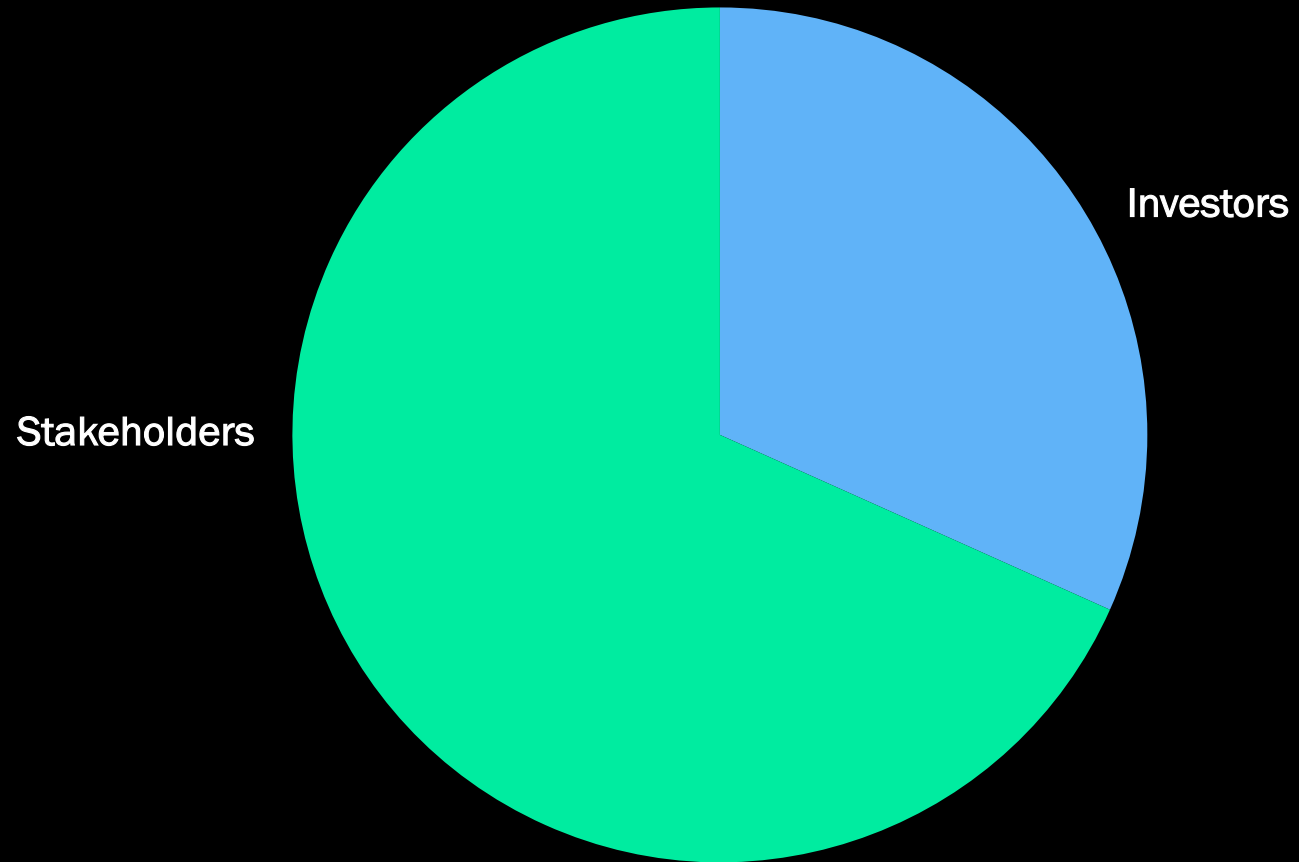
- “As much as needed, for as long as needed”
- Partnered with WHO, World Bank, UNICEF
- Longest-running disease-specific drug donation programme
- 2.7 billion treatments, 300 million people per year
- WHO has certified Columbia, Ecuador, Mexico, and Guatemala as having eliminated river blindness

Merck

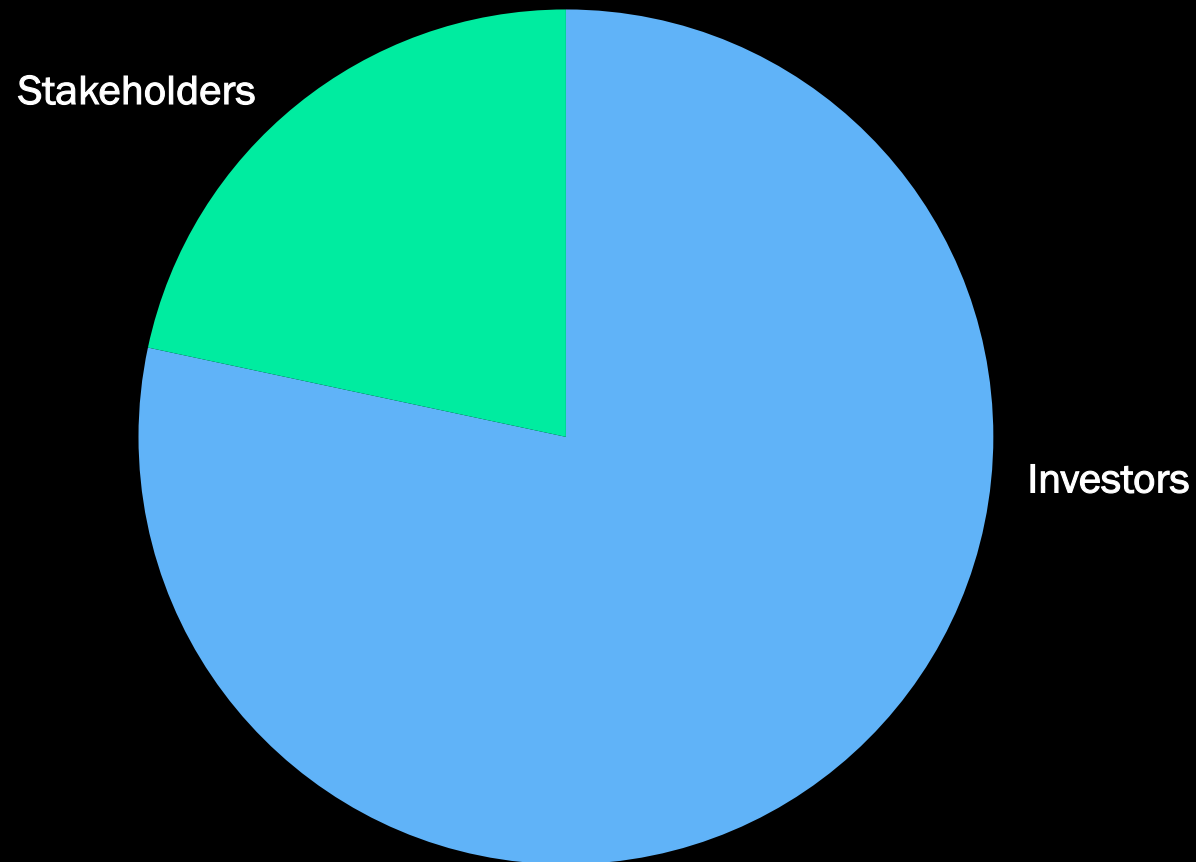
- January 1988
 - *BusinessWeek*: “the best in public service”
 - *Fortune*: “America’s most admired company”
- Ten years after launch, Vagelos hadn’t received any shareholder complaints about MDP
- Many employees wrote to Merck saying they joined it due to MDP



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DARAPRIM PRICE HIKE

COST OF TABLET



PREVIOUSLY
\$13.50

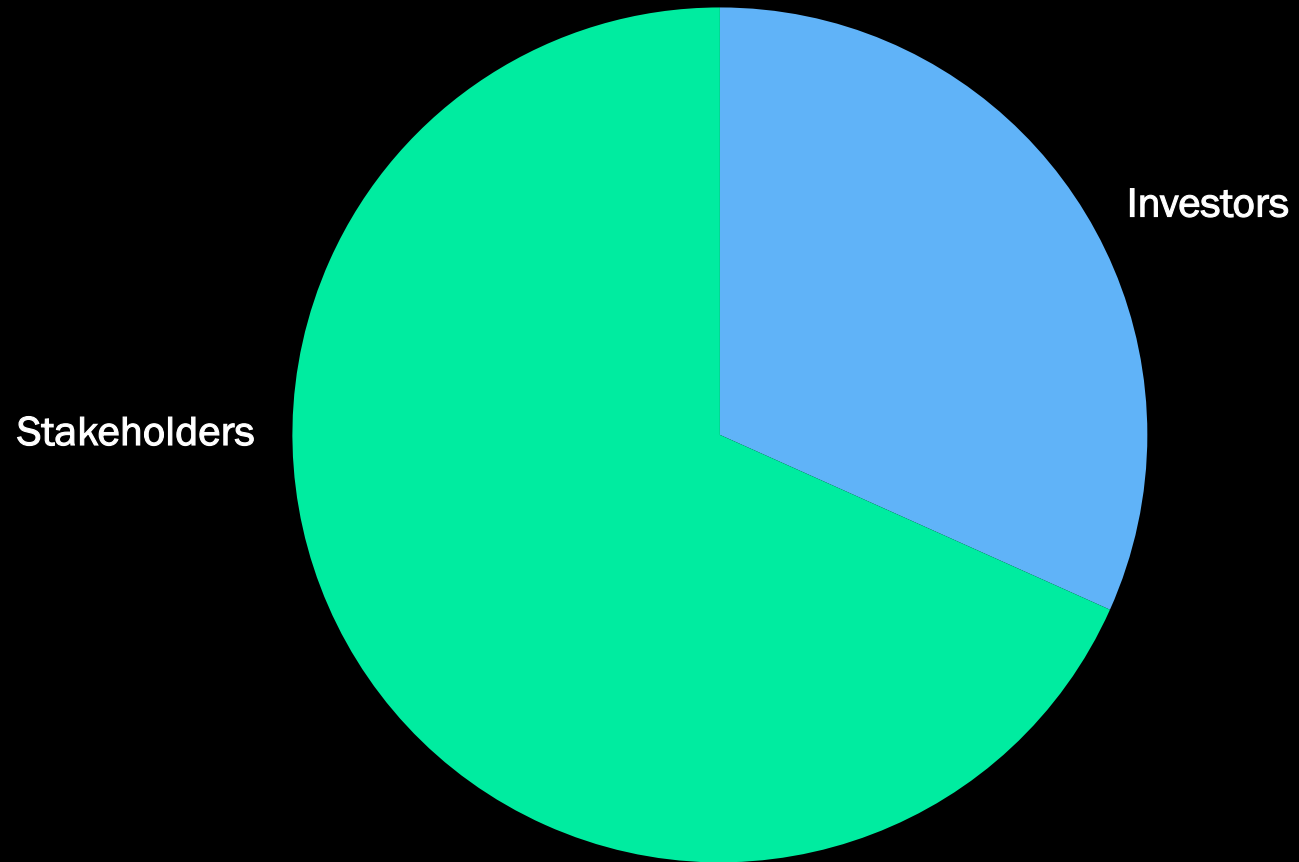


NOW
\$750

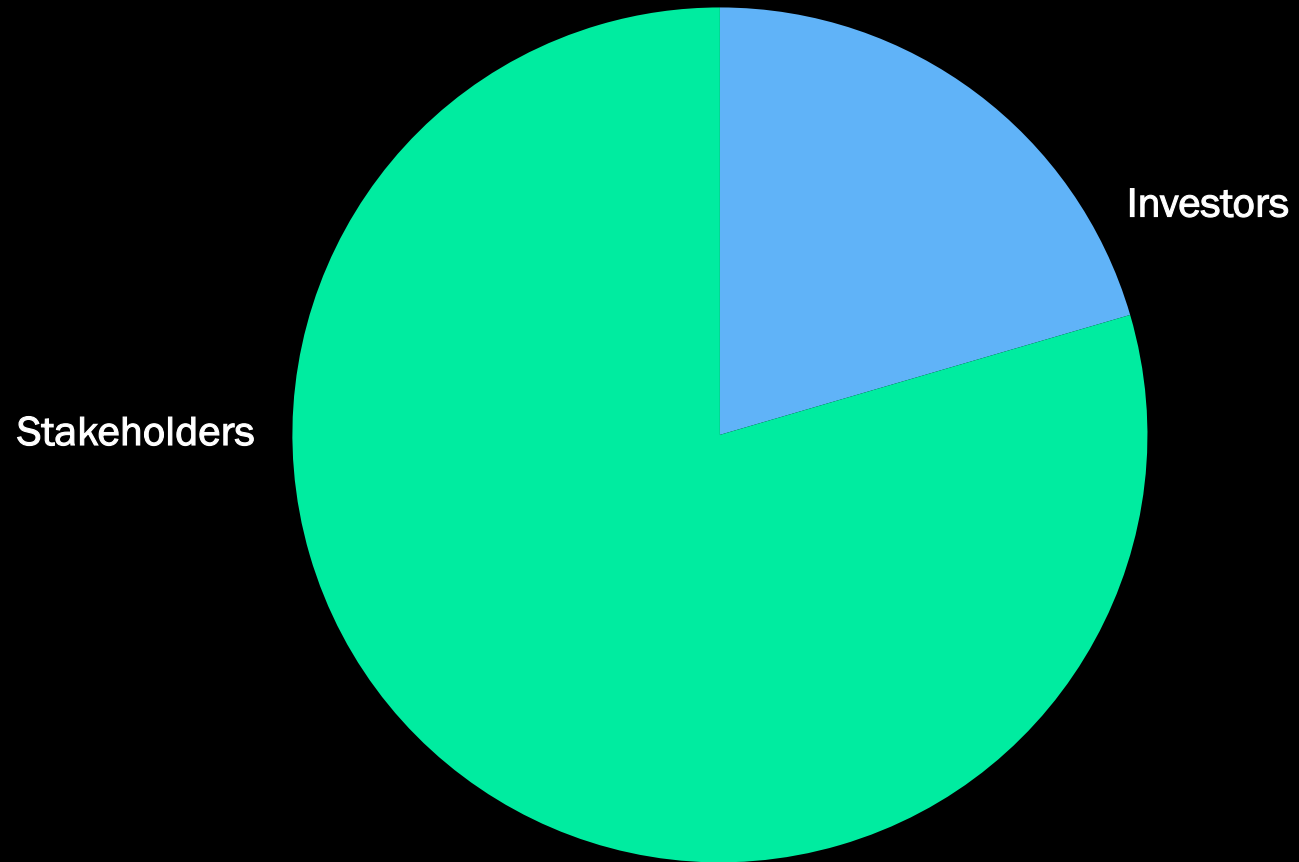
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AFL-CIO

More for Them, Less for Us

\$13.9M

The average compensation for an S&P 500 CEO last year.

361

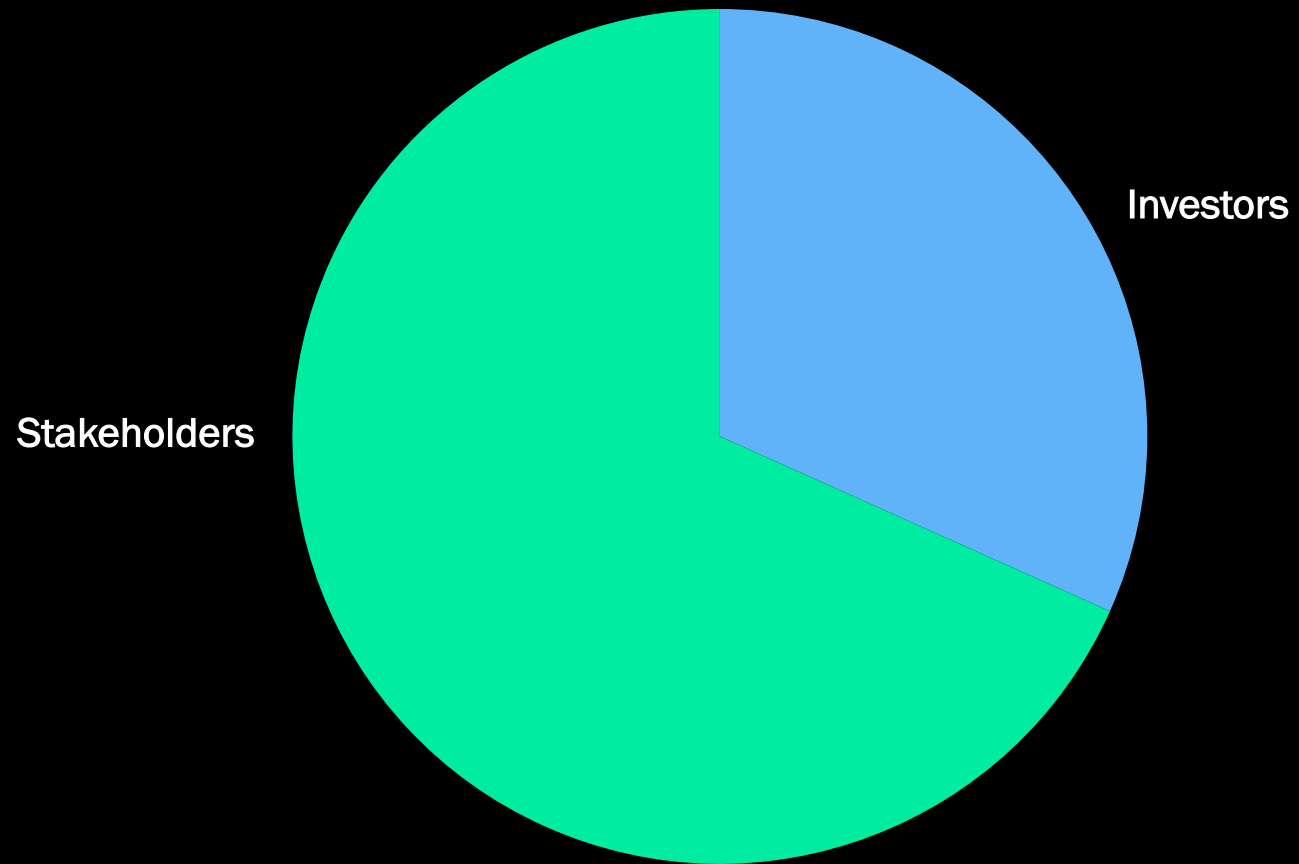
Times more the average S&P 500 CEO made last year compared to the average U.S. rank-and-file worker.

4,987

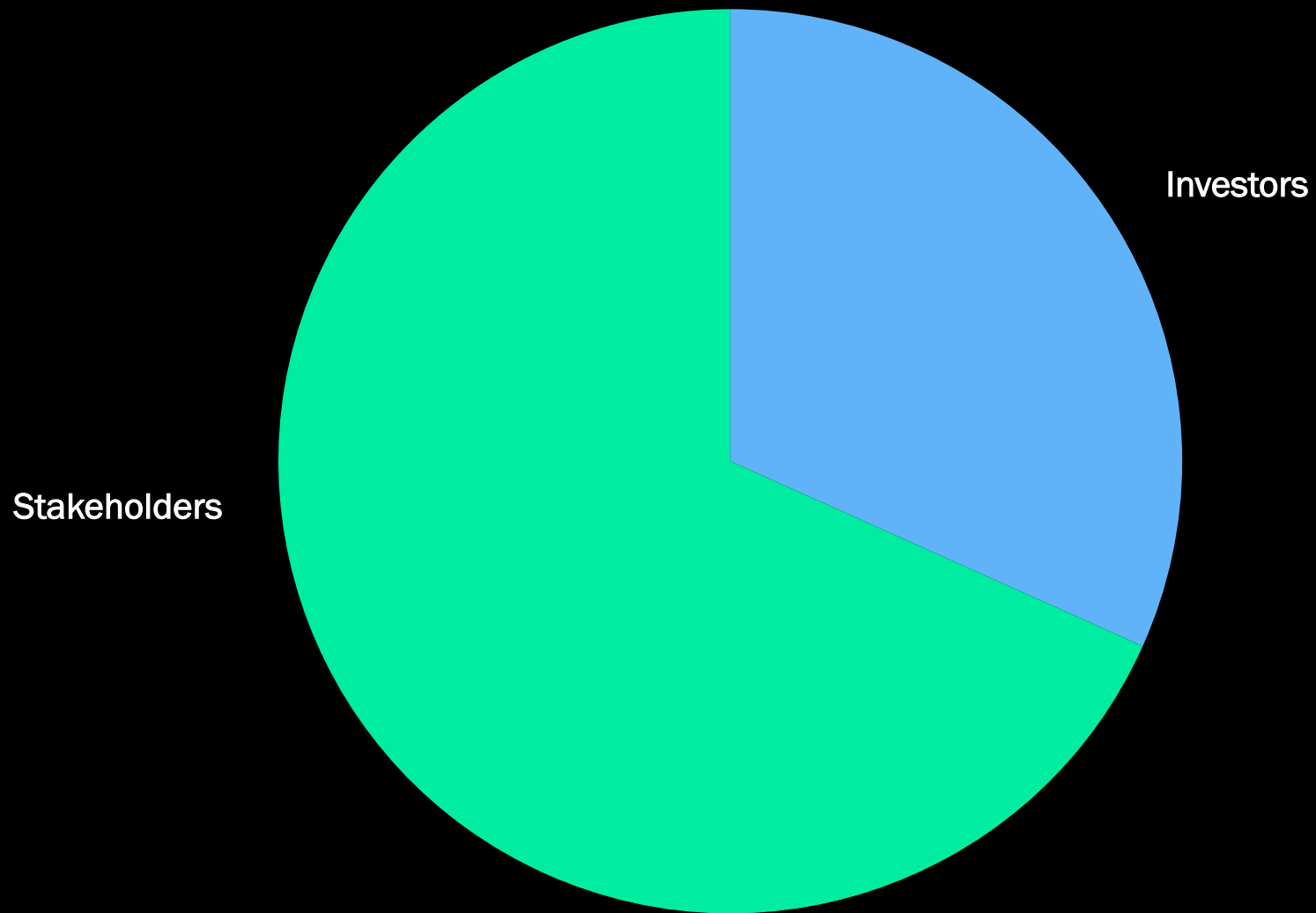
Times more the CEO of Mattel made last year compared to the pay of its median employee.

791

Times more the average S&P 500 CEO in the retail industry made last year compared to the average median pay of their employees.



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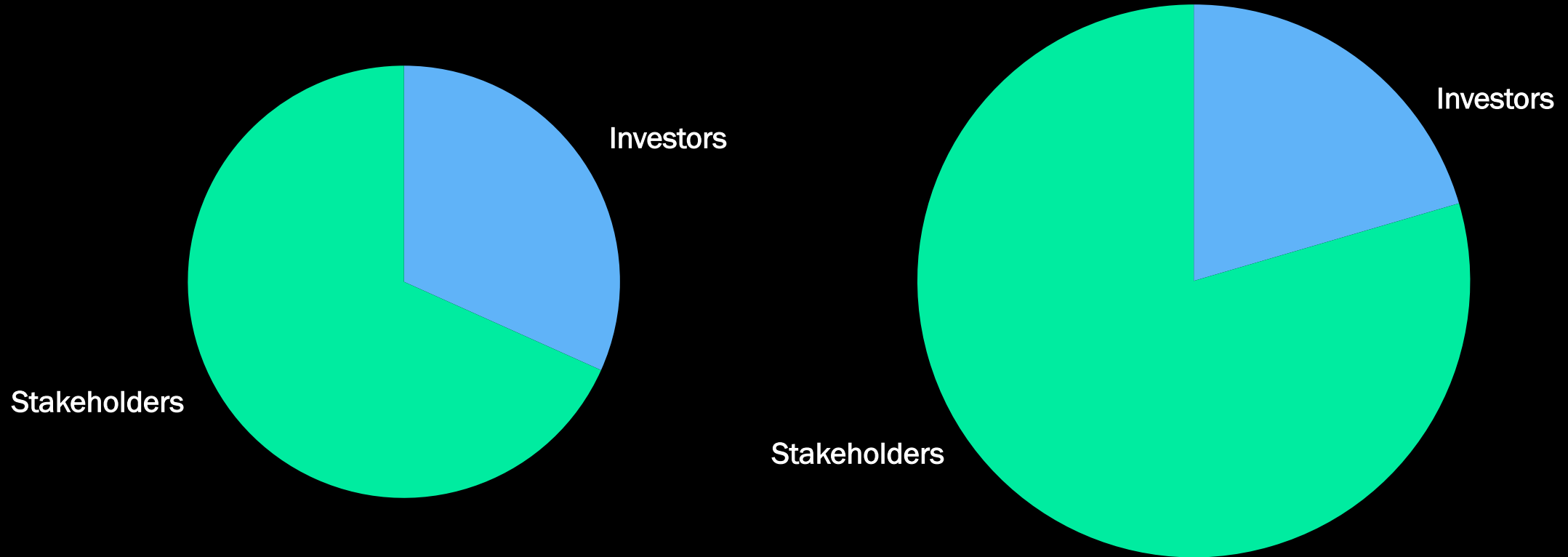
What Is A Responsible Business?

- One that grows the pie, rather than just profits
 - Creates profits through creating value for society
- High profits are not an automatic sign of irresponsibility
- The most irresponsible actions are errors of omission, not *errors of commission*
 - Kodak
- The most responsible actions that a company can take are not to split the pie differently (cut CEO pay, sacrifice profits to reduce carbon emissions)
 - Pie-splitting mentality shared by some critics of business / advocates for business reform

Instrumental vs. Intrinsic

- Milton Friedman: “the social responsibility of business is to increase profits”
 - Stakeholders are important, but only as an *instrumental* way to increase profits
- Should Apple build a gym?
- A responsible business is *intrinsically* motivated by the desire to create value for society, and sees profits as a by-product
- Shift in thinking will lead to far more investments being made, especially intangible ones

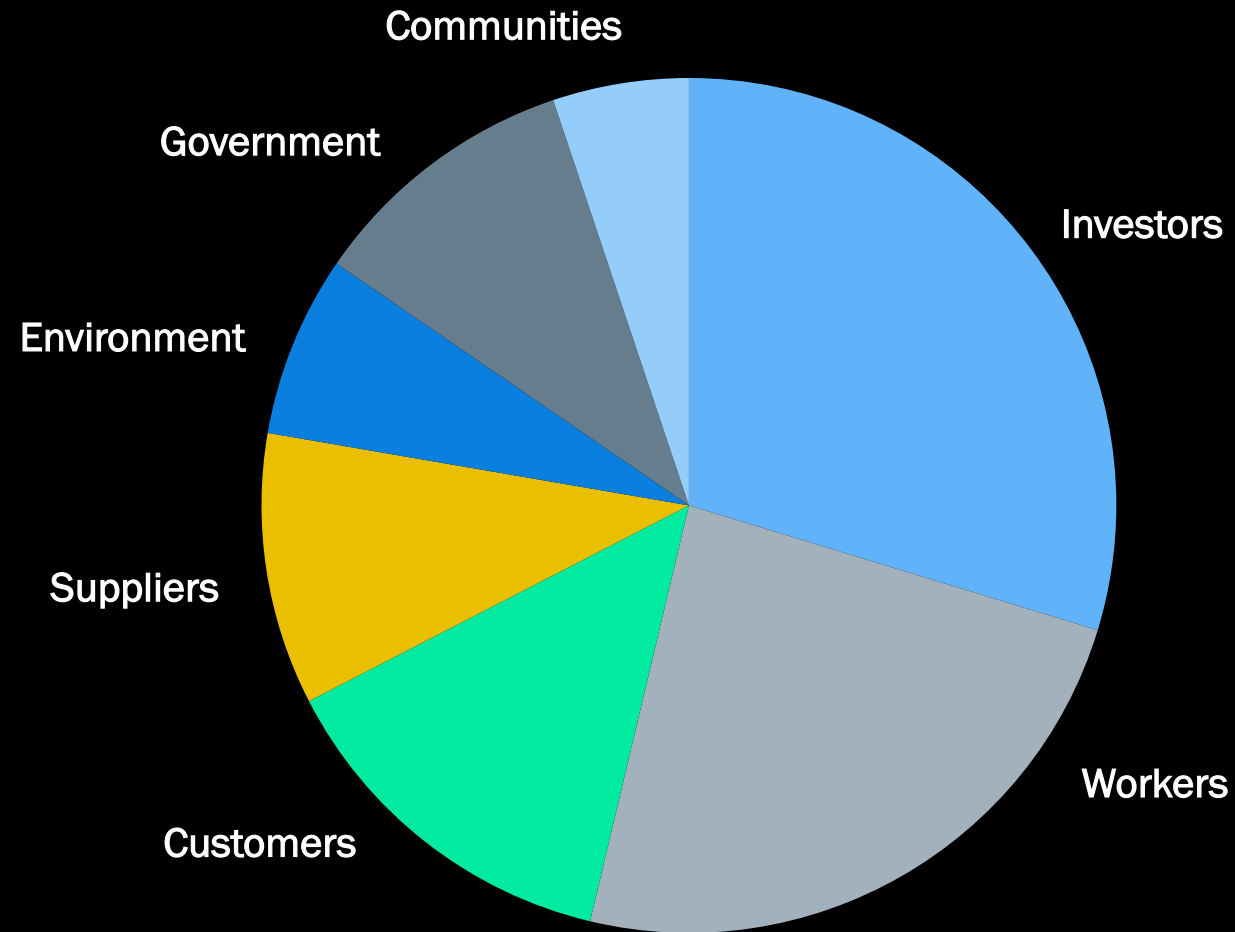
Profits vs. Externalities



Source: Alex Edmans, "Purposeful Business", Gresham College, October 10, 2018, <https://youtu.be/6riKL8uPPqM>

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The Caveats

- Growing the pie does not mean
 - Ignoring profits
 - Growing the firm
- Principle of multiplication
 - Social benefits > private costs
- Principle of comparative advantage
 - Social benefits > social costs, so activity creates value for society
- Principle of materiality
 - Creates profits through creating value for society

II. The Evidence

Pensioner who has smoked 292,000 cigarettes celebrates his 100th birthday

By **DAILY MAIL REPORTER**

UPDATED: 05:05, 25 September 2010



Source: Alex Edmans, "From post-truth to pro-truth", TEDx Talks, June 30, 2017, <https://youtu.be/eUvp5L8yRPQ>

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The Misuse of Evidence

TUC submission to the UK Parliament: *“A second study ... found that firm productivity is negatively correlated with pay disparity between top executive and lower level employees”*



The determinants and effects of CEO–employee pay ratios ☆

Olubunmi Faleye^{a, 1}, , Ebru Reis^b, , , Anand Venkateswaran^{a, 2}, 

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<http://dx.doi.org/10.1016/j.jbankfin.2013.03.003>

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Highlights

- We study the determinants and effects of the relative compensation of top executives and lower-level employees.
- We find that CEO–employee pay ratios depend on the balance of power between the CEO and ordinary employees.
- We find that employees do not perceive higher pay ratios as an inequitable outcome.
- We do not find a negative relation between relative pay and employee productivity.
- We find that firm value and operating performance both increase with relative pay.

Source: Alex Edmans, “Executive Pay: What’s Right, What’s Wrong and What Could Be Fixed?”, Gresham College, January 9, 2019, <https://youtu.be/zirrl3kXxR0>

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The Misuse of Evidence

Executive Pay

+ Add to myFT

UK chief executives earn much more than European peers

Study also fails to find link between higher pay and better performance

- But the study did not actually exist

Source: Alex Edmans, "Executive Pay: What's Right, What's Wrong and What Could Be Fixed?", Gresham College, January 9, 2019
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Confirmation Bias

“Joe Bower and Lynn Paine “had me at hello” ... with their new HBR article, “The Error at the Heart of Corporate Leadership.” ... Investors would have an additional \$1 trillion, workers would have an additional 5 million jobs, and the country would have more than an additional \$1 trillion in GDP.”

— Roger L. Martin, HBR

THE 100 BEST COMPANIES TO WORK FOR FORTUNE

GOOGLITES
Yes, the
employees
really are this
happy.



Source: Alex Edmans, "The social responsibility of business", TEDx Talks, July 9, 2015, <https://youtu.be/Z5KZhm19EQ0>

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The Results

	Excess returns over		
	Market	Industry	Characteristics
Panel A			
α	0.31	0.19	0.24
	(3.52)***	(2.90)***	(2.95)***
Panel B (winsorized at 5%)			
α	0.33	0.22	0.27
	(3.56)***	(2.77)***	(3.09)***
# obs	333	333	333

TEDx talk, “The Social Responsibility of Business”

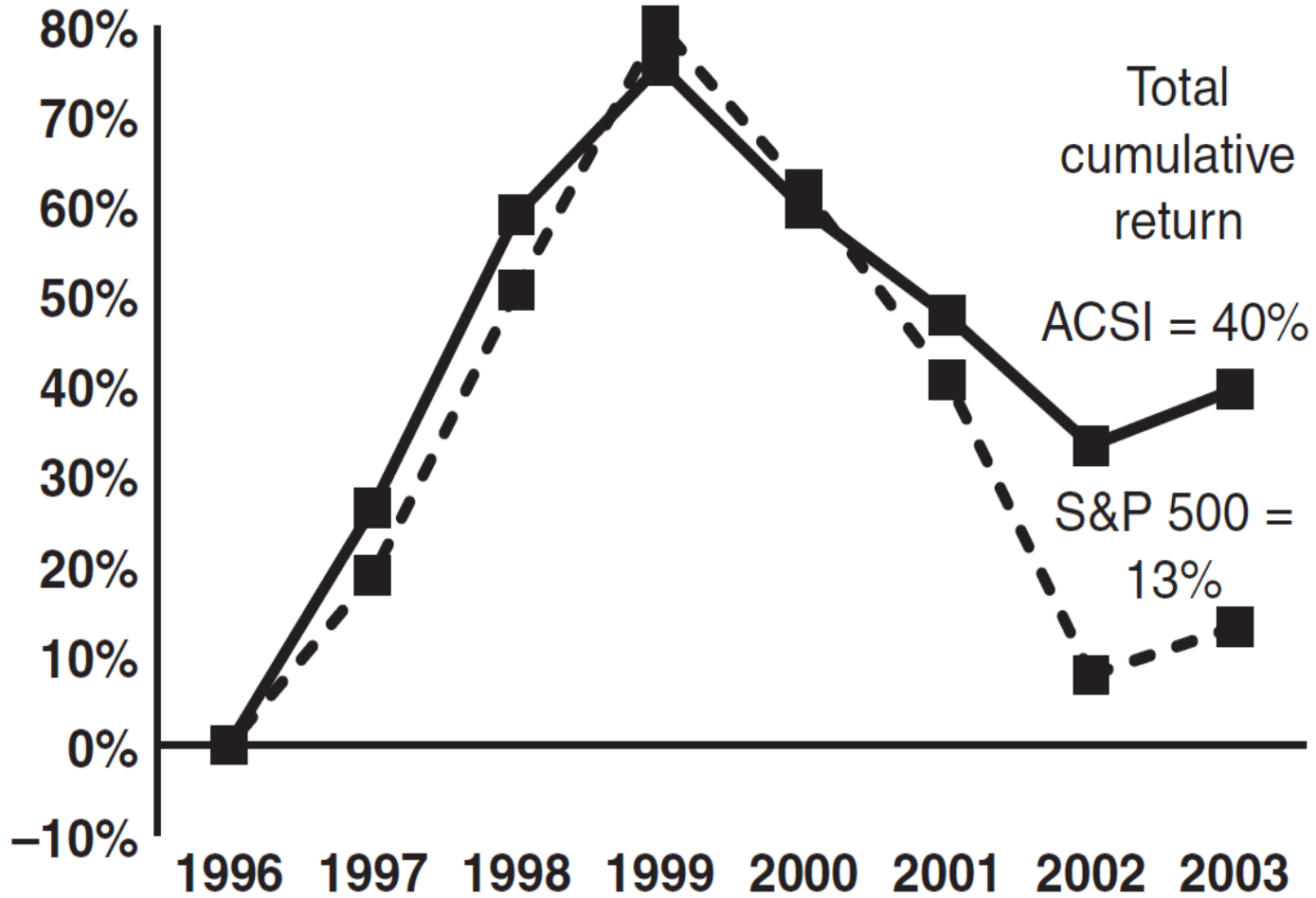
<http://bit.ly/csrtedx>

Source: Alex Edmans, “The Social Responsibility of Business”, TEDx Talk, July 9, 2015, <http://bit.ly/csrtedx>

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ACSI

American
Customer
Satisfaction
Index®



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Fornell, Mithas, Morgeson, and Krishnan (2006)

Portfolio	α
High-ranked companies (full period)	3.98%* (1.93)
Low-ranked companies (full period)	-1.08 (-0.55)
Difference portfolio Full period	5.06* (1.86)



Derwall, Guenster, Bauer, and Koedijk (2005)

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Returns to High and Low Sustainability: Eccles, Ioannou, and Serafeim (2014)

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CSR Proposals

- Flammer (2015)
- *“[T]he shareholders request that the company commit itself to the implementation of a code of conduct based on the aforementioned ILO human rights standards and United Nations’ Norms on the Responsibilities of Transnational Corporations with Regard to Human Rights, by its international suppliers and in its own international production facilities, and commit to a program of outside, independent monitoring of compliance with these standards.”*
- *“The Shareholders request that management implement equal employment opportunity policies based on the aforementioned principles prohibiting discrimination based on sexual orientation and gender identity.”*
- Implementing a CSR proposal increases shareholder value by 1.77%
 - Operating performance, labor productivity, sales growth improve

III. The Implementation

1. Excellence

- Simply being excellent at what you do has major impact on customers, employees, suppliers, the environment, and society
- Implications:
 - Excellence is the best form of service, not reducing carbon footprint or making sacrifices
 - (Almost) all companies play a role in serving society
 - All employees play a role in companies
 - (Almost) all tasks play a role for an employee
- Some of the most pie-growing activities will involve errors of commission, e.g. launch of ATM

2. Purpose

- “Growing the pie”, “creating value for society” are general
- A company’s *purpose* is its reason for being – how it aims to create value for society
 - *Why* it exists (principle of comparative advantage)
 - *Who* it exists for (principle of materiality)

2. The “Who” of Purpose

- “Who” is important to guide trade-offs. Customers are important, but who else?
 - Olam: “endeavours to generate economic prosperity, contribute positively to social wellbeing and manage our stewardship of the environment by providing sustainable agricultural products and food ingredients”
 - Southwest: “to provide our Employees a stable work environment with equal opportunity for learning and personal growth”
- Purpose is only meaningful if the converse would also be reasonable
 - A purpose “to serve customers, workers, suppliers, the environment, and communities while generating a returns to investors” is meaningless. Cannot guide trade-offs

ISSUES

	Health Care	Financials	Technology and Communications	Non-Renewable Resources	Transportation
	Click to expand	Click to expand	Click to expand	Click to expand	Click to expand
Environment					
GHG emissions					
Air quality					
Energy management					
Fuel management					
Water and wastewater management					
Waste and hazardous materials management					
Biodiversity impacts					
Social Capital					
Human rights and community relations					
Access and affordability					
Customer welfare					
Data security and customer privacy					
Fair disclosure and labeling					
Fair marketing and advertising					
Human Capital					
Labor relations					
Fair labor practices					
Employee health, safety and wellbeing					
Diversity and inclusion					
Compensation and benefits					
Recruitment, development and retention					

Source: Alex Edmans, "Purposeful Business", Gresham College, October 10, 2018, <https://youtu.be/6riKL8uPPqM>

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2. The Importance of Materiality

- Khan, Serafeim, and Yoon (2016):
 - High KLD scores slightly outperform, but not significant
 - Firms that score high on material issues and low on immaterial issues outperform by 4.83%/year
 - Reverse: -0.38%/year
 - Firms that score high on all issues outperform by 1.5%/year, insignificant

2. Living Purpose

- Purpose is far more than just a mission statement. It must be
 - Communicated externally
 - Embedded internally

3. Incentives for the Long Term

- Common focus is on the level of pay
 - But £5m pay is 0.06% of a £8b firm
- Much more important is the horizon of pay
 - Affects decisions, which have percentage point, not basis point, effects on firm value
 - See "Stop Making CEO Pay a Political Issue" (*Harvard Business Review*), <http://bit.ly/politicspay>; "Link Pay to Wider Societal Benefits" (*Financial Times*), <http://bit.ly/ftceopay>

3. Incentives for the Long Term (cont'd)

- Edmans, Fang, and Lewellen (2017): vesting equity linked to
 - Cuts in investment (R&D, capital expenditure)
 - Analyst forecast revisions
 - Positive earnings guidance
 - Just meeting earnings targets
- Flammer and Bansal (2017): long-term compensation improves
 - Return on assets, net profit margin, sales growth
 - Innovation (number, quality, novelty of patents)
 - CSR (environment, customers, society, esp. employees)

4. Embedding Purpose

- Strategy (Patagonia Common Threads Initiative)
- Culture (L'Oreal 67 ethics correspondents)
- Performance evaluation
- Board priorities and “say-on-purpose”

5. Reporting on Purpose

EMPLOYEE DIVERSITY** ACHIEVED/ONGOING AIM We will report on gender diversity in the UK, Republic of Ireland and our wholly-owned businesses worldwide by 2015, we will aim for 30% female Board members and 35% women in senior roles.	UK AND ROI RETAIL SKILLS ON PLAN AIM Our learning and development programme responds annually to the operational needs of the business. As a minimum, we will continue to provide at least an average of 1.5 days of training per year on retail skills for our Customer Assistants up to 2020.	UK AND ROI RETAIL SKILLS FOR NEW CUSTOMER ASSISTANTS ON PLAN AIM In addition to an ongoing learning and development programme for our existing Customer Assistants, we will also continue to provide an induction programme lasting up to six months for newly recruited permanent Customer Assistants up to 2020.
YOUTH EMPLOYMENT AT M&S** ON PLAN AIM By 2016 we aim to have offered support to 5,000 young unemployed people in the UK with 650,000 hours of training and work experience in order for 50% to find work within three months of their placement as part of our Make Your Mark and Marks & Start programmes.	WORKING FLEXIBLY ACHIEVED AIM We will report on our employees' uptake of working flexibly in the UK by 2015, then take action and set a target to make a significant increase in the levels of working flexibly (e.g. non-maximum hours working, job shares, flexitime, remote working) in our UK and Republic of Ireland operations by 2020.	WELLNESS ACHIEVED/ONGOING AIM We will establish measurements and report on wellness for M&S employees by 2015 to supplement the more traditional measures of employee engagement, considering external best practice.
YOUTH EMPLOYMENT OUTSIDE M&S** ON PLAN AIM By 2016, we aim to work with 100 of our suppliers and share best practice in order to open up more vocational training and work placement opportunities for young unemployed people. We aim to collaborate with other companies to encourage them to do the same.	SUCCESSION PLANNING ACHIEVED/ONGOING AIM By 2015, we aim to make internal appointments to 70% of our top 150 most senior vacancies.	EXTEND EMPLOYEE HEALTH SERVICES ACHIEVED/ONGOING AIM By 2015, in the UK and Republic of Ireland we will provide additional health services and policies to employees including: encouraging healthy eating, promoting exercise and mental health awareness. We will provide support and advice tailored to the needs of an ageing workforce.
MARKS & START** ON PLAN AIM Since the launch of Marks & Start in 2004, we aim to have helped 15,000 people from disadvantaged groups including young unemployed people, single parents, people with disabilities and those at risk of being homeless by offering work placements in our UK stores, offices and suppliers factories by 2016. We're aiming for 50% to find employment within three months of completing their placement.	RESPONSIBLE LEADERSHIP NOT ACHIEVED/ONGOING AIM Our top 100 business leaders will receive training on Responsible Leadership by 2015.	NUTRITIONAL LABELLING – EMPLOYEE CAFES PREVIOUSLY ACHIEVED AIM Continue to improve nutritional labelling by making it easier for employees to manage their diet and extend it to include UK employee cafés (up to 2015).

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IV. Conclusion

Conclusion

- Responsible businesses' primary goal is to create value for society – to grow the pie
- The evidence suggests that higher profits typically manifest as a by-product
- Society should evaluate companies based on pie-growing and errors of omission, not pie-splitting and errors of commission
 - Same principles apply to reform
- Responsible businesses pursue excellence and are driven by purpose
 - Purpose must move beyond a mission statement and be communicated externally and embedded internally

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