Doing well by doing good
Arguments for and against Stakeholder Capitalism

IRG, January 2022

Multiple overlapping approaches currently attempting to drive a shift from Shareholder to Stakeholder Capitalism

1. ESG
2. Purpose-Driven Corporations
3. B-Corps
4. United Nations SDG
5. Business RoundTable
6. Humanized Growth

Etc.

Why this shift now – when things are going well?

- Last few decades seen massive reduction in poverty – UN data shows more than 1 billion people lifted out of extreme poverty since 1990.
- Some of the most valuable companies in history have been created – Apple, Amazon, Alibaba, Tencent, Meta, Alphabet, Netflix etc.
- Widespread adoption of broadband and mobile have helped developing nations leapfrog forward.
- Breakthroughs have occurred in preventing/treating endemic diseases – Malaria, Covid.
- New technologies helping improve food systems and reducing environmental impact.

Why this shift now – because things are going so badly?

- Fragmentation of societies into self reinforcing filter bubbles
- Wealth bifurcation – gap between rich and poor continues to widen – the wealthy grew richer during Covid
- Nationalism/Populism spreads across the world – loss of trust in key institutions
- Climate crisis deepens and international agreements to address remedies mostly toothless
- Great Resignation – Covid has caused low-paid workers in many countries to reevaluate their current jobs
- Failures at certain leading companies that became too profit-driven – Boeing, Purdue, Evergrande etc.

5 reasons to adopt a stakeholder driven approach

1. It is in line with consumer expectations

Results from the Edelman Trust Barometer 2022, showed that for the 36,000 respondents in 28 countries surveyed, business is again the most trusted institution around the world, while government and media have entered what Edelman calls “a distrust spiral,” pursuing “exaggeration and division to gain clicks and votes.”

The survey also shows that, by large margins, respondents in the markets surveyed want business to play a larger role on climate change, economic inequality, workforce reskilling and addressing racial injustice.

https://www.edelman.com/trust/2022-trust-barometer

1. It is in line with consumer expectations

Research indicates that brand choice is becoming increasingly influenced by perceptions of how companies treat all of their stakeholders

In a global survey by Accenture of over 30 000 consumers responding to the question ‘What attracts you to buy from certain brands over others (beyond price and quality)?:

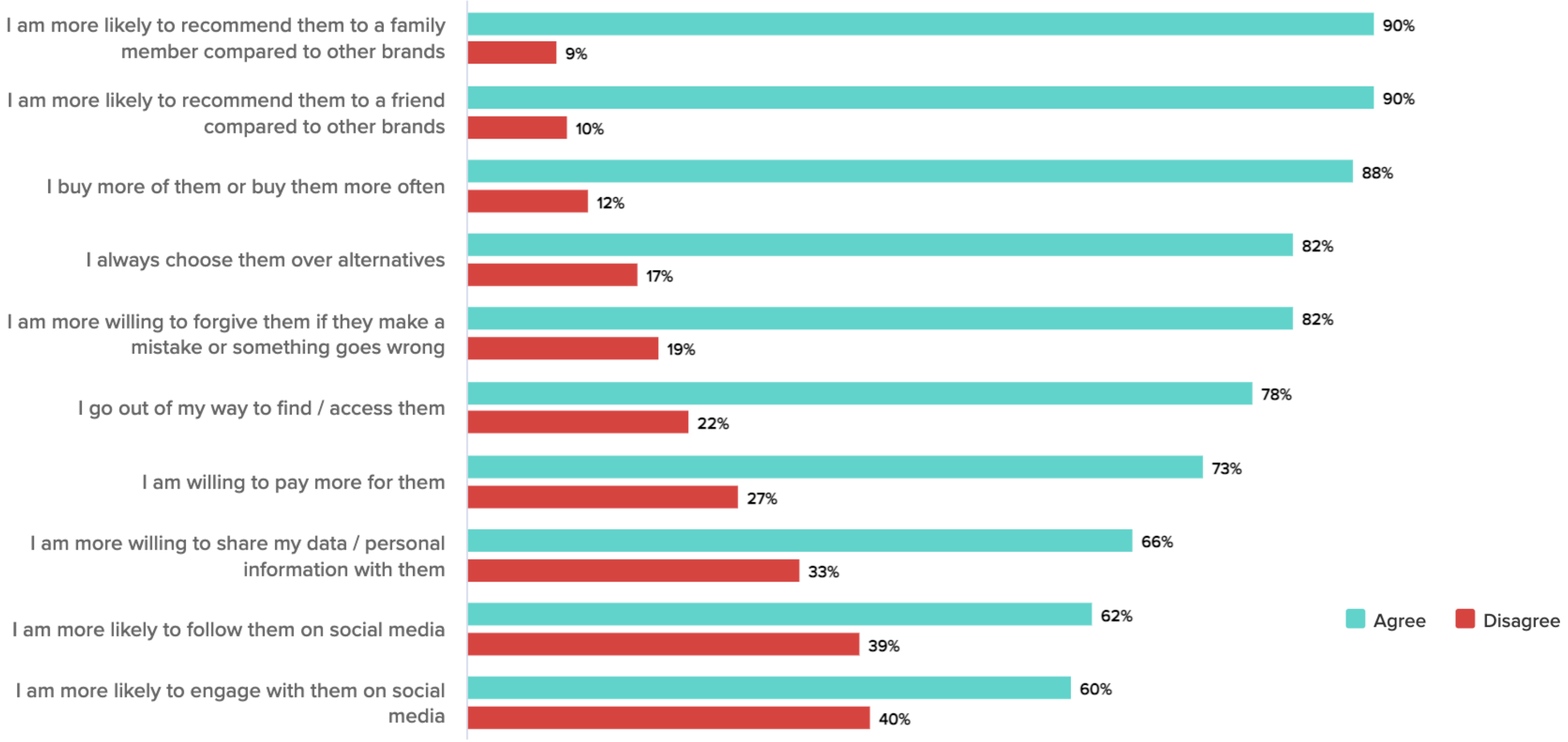
- 62% of respondents said that ‘the brand has ethical values and demonstrates authenticity in everything it does’
- 65% said ‘the brand treats its employees well’
- 66% said ‘the company is transparent – with where it sources its materials, how it treats employees fairly, etc.’
- 66% said ‘the brand has a great culture – it does what it says it will do and delivers on its promises’

‘Companies that don’t step up pay the price. More than half (53 percent) of consumers who are disappointed with a brand’s words or actions on a social issue complain about it. That’s not surprising. Customers have always complained. What’s different now is that 47 percent walk away in frustration, with 17 percent not coming back. Ever.’

https://www.accenture.com/us-en/insights/strategy/brand-purpose

1. It is in line with consumer expectations

Similar research by IRG Partner Morning Consult found that Consumers are more likely to seek out, pay more for, buy more of a brand if they trust it



2. Investors and shareholders increasingly favor this approach

In a famous 2018 letter to the CEO's of companies his funds had invested in, Larry Fink CEO of BlackRock (the world's largest asset manager, with US$10 trillion in assets under management) said :

> "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society".

https://www.nytimes.com/2018/01/15/business/dealbook/blackrock-laurence-fink-letter.html

Fink has held steady to this stance – making this clear in his 2022 letter:

> "Stakeholder capitalism is not about politics. It is not a social or ideological agenda. It is not "woke." *It is capitalism*, driven by mutually beneficial relationships between you and the employees, customers, suppliers, and communities your company relies on to *prosper*. This is the power of capitalism.
>
> In today's globally interconnected world, a company must create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders. It is through effective stakeholder capitalism that capital is efficiently allocated, companies achieve durable profitability, and value is created and sustained over the long-term. Make no mistake, the fair pursuit of profit is still what animates markets; and long-term profitability is the measure by which markets will ultimately determine your company's success."

https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

2. Investors and shareholders increasingly favor this approach

Researchers at Oxford's Said School of Business have found that although many corporate executives believe adopting a sustainability agenda is contrary to the wishes of their shareholders this is increasingly not the case:

> "We recently interviewed 70 senior executives at 43 global institutional investing firms, including the world's three biggest asset managers (BlackRock, Vanguard, and State Street) and giant asset owners such as the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), and the government pension funds of Japan, Sweden, and the Netherlands. We know of no other research effort that involved so many senior leaders at so many of the largest investment firms. We found that ESG was almost universally top of mind for these executives.
>
> Of course, investors have been voicing concerns about sustainability for several decades. But not until recently have they translated their words into action. Most of the investment leaders in our study described meaningful steps their firms are taking to integrate sustainability issues into their investing criteria. It was clear to us that corporate leaders will soon be held accountable by shareholders for ESG performance—if they aren't already."

https://hbr.org/2019/05/the-investor-revolution

2. Investors and shareholders increasingly favor this approach

Investments are increasingly shifting to companies who adopt ESG standards in their corporate governance:

> “Faced with the ongoing calamity of climate change, both seasoned investors and those new to the market are increasingly embracing funds with more sustainable stocks. They’re favoring companies that take action to address the climate crisis and other environmental and social issues, like resource conservation, biodiversity, and human rights—rather than continuing to fund fossil fuel activities.”

> “2021 was a record year for ESG, with an estimated $120 Billion poured into sustainable investments, more than double the $51 billion of 2020. As of this year, an estimated one-third of all assets contain sustainable investments. Still, there’d already been tremendous growth for years: the amount invested in ESG Increased tenfold from 2018 to 2020, and 25-fold from 1995 to 2020.

https://www.fastcompany.com/90706552/esg-investing-continued-to-soar-in-2021-the-government-could-boost-it-even-more

3. It delivers better results

Multiple Research Studies have shown that companies adopting a stakeholder driven approach tend, on aggregate, to outperform their peers:

> ‘There is growing evidence that companies that take a long-term view—and stakeholder capitalism requires that—perform better. In a study that looked at 615 large- and mid-cap US publicly listed companies from 2001–15, the McKinsey Global Institute that those with a long-term view outperformed the rest in earnings, revenue, investment, and job growth’.
>
> ‘Other McKinsey research concluded that companies with strong environmental, social, and governance norms recorded higher performance and credit ratings through five factors: top-line growth, lower costs, fewer legal and regulatory interventions, higher productivity, and optimized investment and asset utilization.’
>
> https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-case-for-stakeholder-capitalism

3. It delivers better results

Work at Morgan Stanley has shown that sustainable investing delivers no trade-off in overall results versus traditional funds but comes with with lower risk:

> “The myth that sustainable investing requires a financial tradeoff has been surprisingly sticky, despite research demonstrating that companies with strong social or environmental practices outperform their peers on a variety of measures,” says Matthew Slovik, Head of Global Sustainable Finance at Morgan Stanley. “By looking at thousands of mutual funds across multiple asset classes, we found that sustainable investments can help investors meet a variety of financial objectives for generating returns and managing risk.”
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> In its white paper, “Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds,” Morgan Stanley analyzed 10,723 funds, using Morningstar data on exchange traded and open-ended mutual funds active in any given year from 2004-2018. The key findings:
>
> - There is no financial tradeoff in the returns of sustainable funds and traditional funds. No consistent or statistically significant difference in total returns existed between ESG-focused and traditional mutual funds and ETFs.
> - Sustainable funds may offer lower market risk. Sustainable funds experienced a 20% smaller downside deviation than traditional funds, a consistent and statistically significant finding.

https://www.morganstanley.com/ideas/sustainable-investing-competitive-advantages

4. It attracts and motivates employees

Multiple studies have shown that companies that have a clear purpose and who adopt a stakeholder driven approach are able to attract the best candidates and have the most committed employees:

> ‘When organizations define their success through the eyes of their customers, stakeholders, or society, people come alive. Our research shows that “mission-driven” companies have 30 percent higher levels of innovation and 40 percent higher levels of retention, and they tend to be first or second in their market segment.’

> ‘When you offer people a mission and purpose greater than financial return, you attract passionate individuals who want to contribute. And that brings a level of commitment and engagement no compensation package can create.’

https://www2.deloitte.com/us/en/insights/deloitte-review/issue-16/employee-engagement-strategies.html

4. It attracts and motivates employees

In its work attempting to understand the key forces influencing growth for modern corporations, McKinsey concludes:

> 'Employees, too, will reward companies that are part of the experiments ahead. About 85% of employees working at companies engaged in societal issues said they are committed to achieving their leadership's strategy, motivated to perform and have confidence in the future of their company – some 20% more in each case than employees of companies not engaged'.

> https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-global-forces-inspiring-a-new-narrative-of-progress

4. It attracts and motivates employees

Research conducted by leading business schools - Harvard, Wharton and Columbia have linked purposeful activity with productivity and performance improvements driven by employee engagement:

> "…high purpose firms come in two forms: firms characterized by high camaraderie between workers and firms characterized by high clarity from management. We document that firms exhibiting both high purpose and clarity have systematically higher future accounting and stock market performance, even after controlling for current performance, and that this relation is driven by the perceptions of middle management and professional staff rather than senior executives, hourly or commissioned workers.
>
> Taken together, these results suggest that firms with mid-level employees with strong beliefs in the purpose of their organization and the clarity in the path towards that purpose experience better performance."
>
> https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2840005

5. It makes companies more resilient

In research into ESG, conducted by McKinsey the company concluded:

‘The magnitude of investment flow suggests that ESG is much more than a fad or a feel-good exercise.

So does the level of business performance. The overwhelming weight of accumulated research finds that companies that pay attention to environmental, social, and governance concerns do not experience a drag on value creation—in fact, quite the opposite. A strong ESG proposition correlates with higher equity returns, from both a tilt and momentum perspective. Better performance in ESG also corresponds with a reduction in downside risk, as evidenced, among other ways, by lower loan and credit default swap spreads and higher credit ratings.’

‘A Strong ESG proposition helps companies tap new markets and expand into existing one. When governing bodies trust corporate actors , they are more likely to award them the access, approvals and licenses that afford fresh opportunities for growth.’

“A stronger external-value proposition can enable companies to achieve greater strategic freedom, reduced regulatory pressure. In fact, in case after case across sectors and geographies, we’ve seen that strength in ESG helps reduce companies’ risk of adverse government action. It can also engender government support.

The value at stake may be higher than you think. By our analysis, typically one-third of corporate profits are at risk from state intervention.”

https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value

5 reasons NOT to adopt a stakeholder driven approach

1. Many of the so-called stakeholder approaches adopted by corporations are just wokewashing/greenwashing

Investigations into how signatories to the Business Roundtable's 'Statement of a purpose of a corporation' responded to pandemic found:

> 'The coronavirus, its attendant economic devastation and the ongoing movement against racial injustice have collectively posed the first test of the lofty words proclaiming a kinder form of capitalism. The results have fallen short of the promise…its signatories have done no better than other companies in protecting jobs, labor rights and workplace safety during the pandemic, while failing to distinguish themselves in pursuit of racial and gender equality.'

https://www.nytimes.com/2020/09/22/business/business-roudtable-stakeholder-capitalism.html

1. Many of the so-called stakeholder approaches adopted by corporations are just wokewashing/greenwashing

In a column for Marketing Week, Marketing Professor Mark Ritson noted:

> ‘Time and again we encounter the lofty, admirable sheen of brand purpose only to discover it flakes off with even the slightest scratch to reveal a darker, more commercial sub-surface beneath. Starbucks’ famous mission ‘to inspire and nurture the human spirit — one person, one cup and one neighbourhood at a time’ is about as lofty as it gets. But it contradicts mightily the company’s abject inability to align its tax responsibilities accordingly.
>
> For its first 14 years of operation in the UK Starbucks averaged just over £600,000 a year in tax on £3bn of cumulative revenue, according to a Reuters investigation in 2012. For the most recent tax year, the Financial Times estimated the effective tax rate paid by Starbucks’ European operations, based in the UK, was still around half the level of corporate tax paid by most British businesses.’

https://www.marketingweek.com/mark-ritson-true-brand-purpose-doesnt-boost-profit-sacrifices/

2. ESG Ratings are often corporate 'theatre'

ESG standards are not consistent. Multiple different approaches which allow companies to 'game' the system. E.g., Social Media companies which are widely believed to have widespread negative impacts on society often appear on list of Top 10 ESG stocks:

> Researchers at MIT's Sloan School of Management recently conducted a study of six top ESG ratings firms and concluded that "ratings from different providers disagree substantially....The correlations between the ratings are on average 0.54, and range from 0.38 to 0.71. This means that the information that decision-makers receive from ESG rating agencies is relatively noisy." In addition, raters often seem unaware of what's actually happening inside companies. For example, both Volkswagen and boohoo, the U.K. fast-fashion retailer, got high marks from ESG ratings firms before their respective scandals came to light (VW's deception regarding diesel car emissions and boohoo's exploitation of factory workers).
>
> https://hbr.org/2021/05/overselling-sustainability-reporting

2. ESG Ratings are often corporate 'theatre'

In a recent report on MSCI, the leading company in producing ESG ratings, BusinessWeek Magazine concluded:

> '...there's virtually no connection between MSCI's "better world' Marketing and its methodology. That's because the ratings don't measure a company's impact on the Earth and society. In fact, the gauge the opposite: the potential impact of the world on the company and its shareholders. MSCI doesn't dispute this characterization. It defends its methodology as the most financially relevant for the companies it rates...
>
> The most striking feature of the system is how rarely a company's record on climate change seems to get in the way of its climb up the ESG ladder – or even factor at all. McDonald's Corp., one of the world's largest beef purchasers, generated more greenhouse gas emissions in 2019 than Portugal or Hungary, because of the company's supply chain. McDonald's produced 54 million tons of emissions that year, an increase of about 7% in four years. Yet on April 23, MSCI gave McDonald's a ratings upgrade, citing the company's environmental practices. MSCI did this after dropping carbon emissions from any consideration in the calculation of McDonald's rating. Why? Because MSCI determined that climate change neither poses a risk nor offer 'opportunities;' to the company's bottom line.'
>
> https://www.bloomberg.com/graphics/2021-what-is-esg-investing-msci-ratings-focus-on-corporate-bottom-line/

3. A stakeholder focus results in underperformance

Unilever, one of the leaders in a shift to a stakeholder driven approach has increasingly come under attack as it results have lagged those of its peers:

“Leading fund manager Terry Smith, explaining to investors in his £29bn Fundsmith fund via his annual letter on Tuesday why the stock was a bottom-five performer in the portfolio: “Unilever seems to be labouring under the weight of a management which is obsessed with publicly displaying sustainability credentials at the expense of focusing on the fundamentals of the business.”

“A company which feels it has to define the purpose of Hellmann’s mayonnaise has in our view clearly lost the plot. The Hellmann’s brand has existed since 1913 so we would guess that by now consumers have figured out its purpose (spoiler alert – salads and sandwiches).”

https://www.theguardian.com/business/nils-pratley-on-finance/2022/jan/11/time-for-unilevers-boss-to-deliver-more-than-mayonnaise

3. A stakeholder focus results in underperformance

At Danone, CEO Emmanuel Faber was removed after being accused of failing to deliver results because of an over-emphasis on addressing sustainability issues:

> ”Faber had turned Danone into an “enterprise à mission,” France’s new category similar to an American B-Corp, whose purpose was far broader than profits and growth. He named his strategy “One Planet, One Health,” and created a carbon adjusted earnings per share indicator, pegging Danone’s success directly to its environmental performance. While that brought applause from climate activists, the company’s shares lagged behind peers like Nestlé and Unilever during the pandemic, as sales of some key Danone products like Evian water plummeted.
>
> Amid the shock of Faber’s ouster, there were roiling questions over what it all meant. Do CEOs now face an impossible dilemma: Either to please their shareholders, or to join the fight for climate justice and social equity? Faber had placed those issues at the core of the company. And outside it, he threw himself into activist CEO coalitions like the B Team and Business for Inclusive Growth, or B4IG. Little wonder, then, that his firing left palpable distress in some circles, from Paris to the U.N. “Are these two objectives, environmental and economic, irreconcilable?” asked France’s liberal Le Monde of Faber’s ouster. “It plunges us into a confusion of emotions over the ethics of capitalism,” the paper said.

https://time.com/6121684/emmanuel-faber-danone-interview/

4. Links between high ESG scores and corporate overperformance are tenuous and often over-stated

Leading experts in Corporate Valuation from NYU and UCLA examining the literature have concluded:

> " The argument that socially responsible companies should generate higher profits, either because they have greater revenues, or face lower regulatory and legal costs, and that these lead to more healthy, sustainable performance seems to rest largely on faith…the evidence that markets reward companies for being 'good' is weak to non-existent, which can either be taken to mean that markets are rationally assessing ESG actions and finding they have little effect on value or that markets are short-sighted and are not incorporating the long-term value increases associated with being more socially conscious. Either conclusion is not promising for ESG advocates; the first undercuts their central thesis that being good translates into doing well, and the second makes it less likely that managers will invest more in ESG, because they will realize few tangible benefits in the market today."

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3557432

5. This is the responsibility of governments not businesses

Research by leading academics into the value of ESG approaches concluded:

> ‘Asking companies to bear the burden of being society’s conscience is not only unfair, but it tilts the playing field in favor of the least socially conscious investors and companies. Put simply, if a subset of investors and companies play by ESG rules, investors in bad companies will earn higher returns than investors in good companies and bad companies will gain market share at the expense of good companies…is it appropriate for company executives, who have been neither elected nor empowered to make social decisions, to decide that prices et in the economy are not appropriate indicators for making corporate decisions because the government has failed to enact the proper policies to account for externalities?’

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3557432

5. This is the responsibility of governments not businesses

In a paper written by Tariq Fancy, ex- Head of Sustainable Investing at BlackRock he concludes:

‘…creating the systemic change we claim to seek means shedding a love affair that has persisted for decades with the illusion that, left to its own devices, the market will magically serve the long-term public interest. The market will not solve rampant and rising inequality all by itself. Nor will the market somehow self-regulate to solve the problem of climate change — a ludicrous idea, given that climate change is widely considered the greatest market failure the world has ever seen. It’s time we all finally accept that only a supreme, overarching authority with democratic legitimacy can and should be leading the way in coordinating our efforts to solve these problems, beginning with uncomfortable rule changes — ones that don’t all have to be bad for business, but can certainly no longer remain business as usual…It’s time to accept that there are nine words that we need to hear, because we can only build a sustainable future once we’re no longer terrified to hear them. *I’m from the government and I’m here to help.’*

https://medium.com/@sosofancy/the-secret-diary-of-a-sustainable-investor-part-3-3c238cb0dcbf

Appendix

the 2019 Statement proclaimed that a corporation's purpose is to deliver value to all stakeholders, rather than to solely maximize shareholder value. However, we find no evidence that BRT members – who voluntarily signed the Statement – have engaged in such stakeholder-centric practices. Relative to within-industry peer firms, publicly listed signatories of the BRT statement commit environmental and labor-related compliance violations more often (and pay more in compliance penalties), have higher carbon emissions, and rely more on government subsidies. BRT firms are also more likely to disagree with proxy recommendations on shareholder proposals. Preliminary evidence from the period subsequent to the signing of the Statement suggests that signatories did not sign the document as a credible signal of a future intention to improve stakeholder-centric behaviors. Our results suggest that firms' proclamations of stakeholder-centric behavior are not backed up by any hard data on these firms' operations.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3609056

3. A stakeholder focus results in underperformance

Recent research by the IPA showed 'that the average purpose campaign was significantly less likely to generate very-strong long-term business effects when compared with 'traditional' non-purpose campaigns'

https://www.marketingweek.com/mark-ritson-good-purpose-bad-purpose/

3. It’s a distraction for CEO’s and companies

- “Stakeholder capitalism” with its call to balance the claims of different stakeholders on a case-by-case base was an invitation to allow innumerable decisions in this morass of differing viewpoints, values, attitudes and ambitions, to be made by different people at different levels of the organization.
- In the absence of clear prioritization among different stakeholders, the result was what management theorists called "garbage can organizations." These were organizations that couldn't make up their minds. Goals wandered in and out meetings and decisions happened randomly, depending on who was present. The organization often had no explicit preferences or guidelines. It frequently operated on the basis of inconsistent and ill-defined preferences, goals, and identities.

https://www.forbes.com/sites/stevedenning/2020/01/05/why-stakeholder-capitalism-will-fail/?sh=23d16289785a

4. Mainly CEO Passion Projects

Shareholders should expect companies to maximize profits and returns – they can decide whether to apply some of their returns to ‘good causes’.