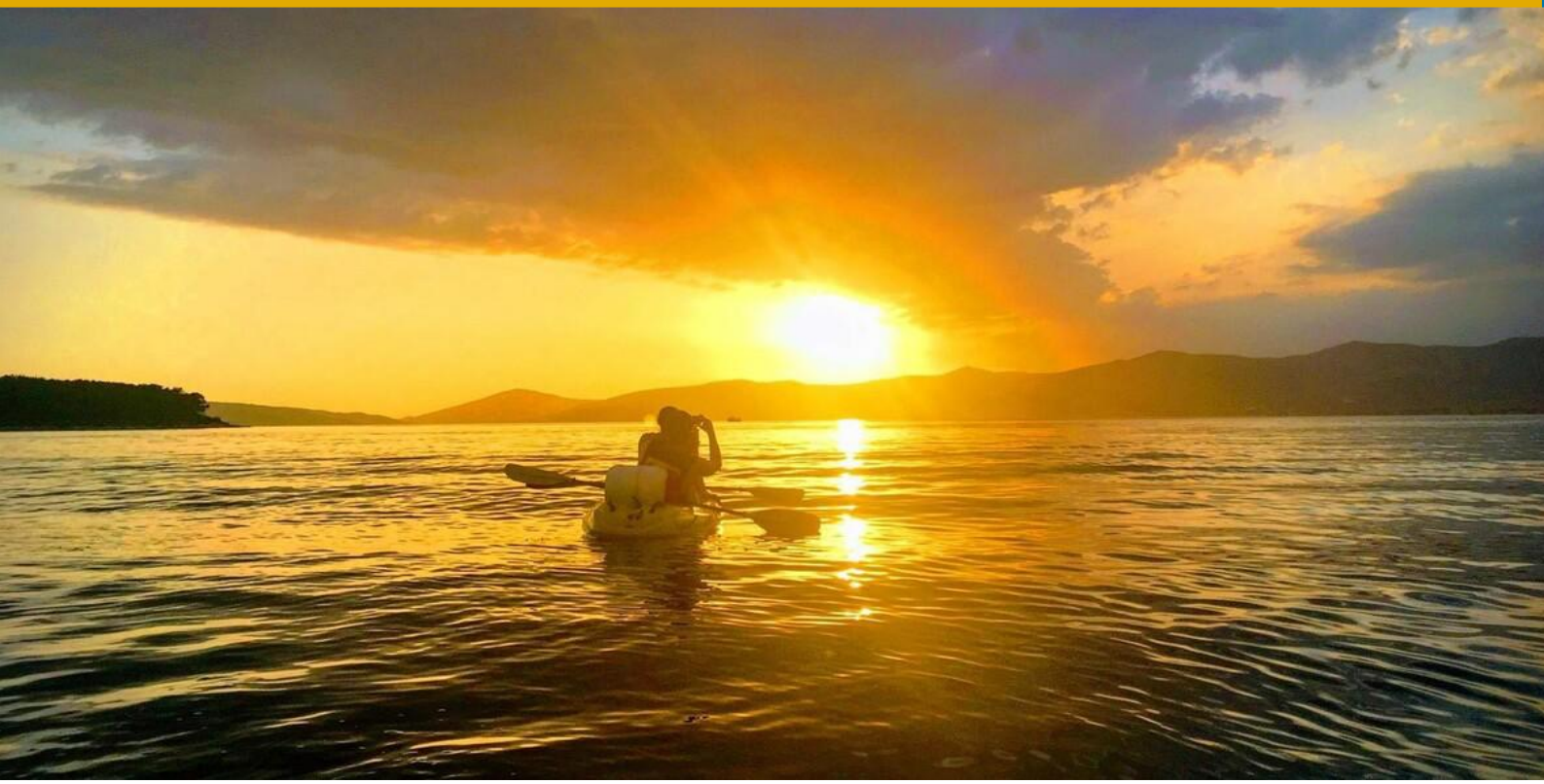
Sustainable and responsible business - the case for change



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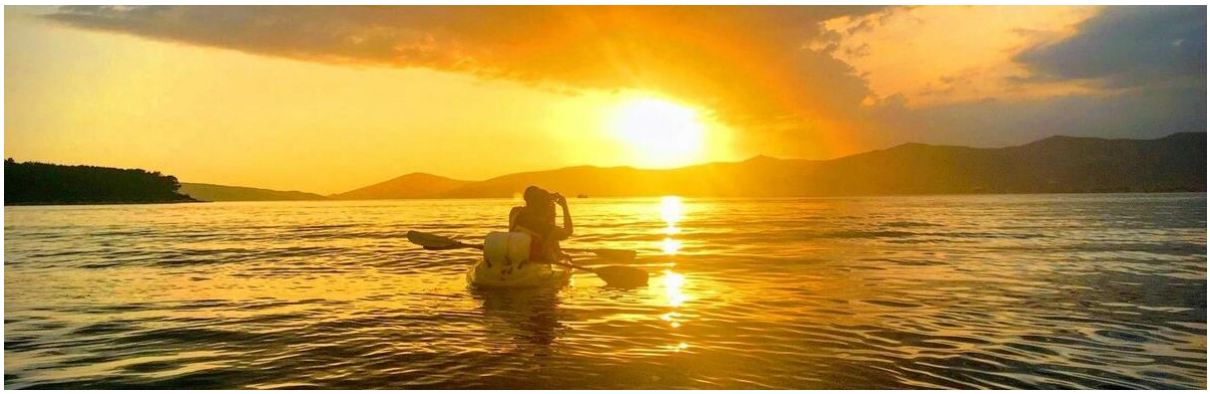

The Nobel Prize winning economist Milton Freidman wrote there is “one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits, so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." [1]

This was written over forty years ago and the world has changed beyond recognition since then. Organisations have had to adapt to the pressures of globalisation, new technology and increased competition, combined in many cases with increased regulation and complexity.

While attractive due to its simplicity, the concept of short-term profit maximisation is often mistakenly equated to creating shareholder value. At the same time this often comes at the expense of long-term sustainable value creation for both shareholders and stakeholders alike. In February 2016, Larry Fink[2], chairman and CEO of BlackRock, an American multinational investment company with more than $6.5 trillion in assets under management, declared that "Today's culture of quarterly earnings hysteria is totally contrary to the long-term approach we need."

Confidence in business is at a low, one of the legacies of the 2008 banking crisis which has seen dwindling sense of public trust in corporations, across all geographies and generational lines, with the share of wealth and opportunity being increasingly perceived as unequal and unfair. It is

the younger generations in particular that are tending to trust business less than their predecessors.

At the same time companies are now competing in a world in which artificial intelligence and robotics are advancing alongside the low-cost and often transactional approaches represented by the growth of the 'gig economy'. Many people who might previously have enjoyed secure jobs are finding themselves working on zero-hour contracts. And at the same time, long-established companies are experiencing rising expectations about the part they should be playing in tackling societal and environmental issues facing the world, such as climate change, human rights and social inequality.

Why change is needed

Research[3] has shown that instead of organisations shifting the way in which they run such that they do so with a "purpose mindset," the majority of millennials and Gen Z youth believe they are going in the opposite direction. Respondents felt there is now a significant gap between a purpose-driven business and how they are in fact operating and they expect more than what is currently being delivered from business leaders.

Two more key statistics highlighted that pessimism felt by millennials:

- 75% believe leaders/business focus on their own agendas rather than considering the wider society
- 62% think leaders/business have no ambition beyond wanting to make money

These finding should potentially set off alarm bells for business.

Firstly, millennials are consumers, and they are unafraid to part ways with their money solely to companies that act ethically and within a purpose mindset. In simple terms, they have no problem voting with their wallet.

Secondly, they are the pipeline of talent not only for business today but for future leadership roles and again there will have no problem in making choices as to who they work for dependant on the behaviours of a company.

They are the most socially and environmentally conscious generation ever and they are prepared to have make their voices heard. They don't just buy a product at face value as a result of a great marketing campaign, they want to know the company behind the brand - have a connection and understand

whether that company have the same values they have. They want to understand why that business exists, what it does, how it treats people and the planet. They want to know what a company's purpose is.

It is not only millennials that are demanding businesses change. Pressure is also mounting from regulators. One of the key themes of recent reforms[4] is the introduction of annual reporting requirements, whereby Directors have a duty to "promote the success of the company for the benefit of its members as a whole", whilst have having regard to various other stakeholder interests. These new changes are aimed at encouraging boards to create a culture whereby decisions are made with greater consideration for the wider impact upon the organisation, beyond the traditional emphasis on just financial performance and strategic objectives.

Similarly, Larry Fink in his 2019 Letter to CEO's[5] "This data should extend beyond climate to questions around how each company serves its full set of stakeholders, such as the diversity of its workforce, the sustainability of its supply chain, or how well it protects its customers' data. Each company's prospects for growth are inextricable from its ability to operate sustainably and serve its full set of stakeholders." He went on to say "The importance of serving stakeholders and embracing purpose is becoming increasingly central to the way that companies understand their role in society. As I have written in past letters, a company cannot achieve long-term profits without embracing purpose and considering the needs of a broad range of stakeholders."

The need for companies to change also lies closer to home. More and more employees are challenge senior management and raising their voices, as illustrated when 20,000 Google employees around the world took part in a mass walk to protest about how the company was handling sexual harassment. This was not a union orchestrated protest but white-collar tech workers, who generally enjoy good salaries and benefit, protesting about what they saw as unacceptable company behaviour.

Similarly, in a recent survey of more than 540 employees worldwide conducted by PwC's strategy consulting business[6], Strategy&, only 28% of respondents reported feeling fully connected to their company's purpose. Just 39% said they could clearly see the value they create, a mere 22% agreed that their jobs allow them to fully leverage their strengths, and only 34% thought they strongly contribute to their company's success.

The role of sustainability and responsible business has moved from the margins of CSR to become business critical. As highlighted, a combination of investor pressure, consumer attitudes, employee activism, regulation and moral imperative, is now beginning to catalyse businesses into action. However, the transition and bridging the gap between continuing to deliver in the short-term and steering an organisation to a more sustainable and responsible future is often complex. One of the primary obstacles is the belief that being sustainable and responsible is about giving things up, which is difficult to square against the concept that a company's sustainability transition is where long-term growth will come from.

Even with strong arguments for change the fundamental understanding of capitalism as articulated by Freidman still dominates business today. For too many organisations, growing stakeholder pressure from within and outside is still not enough to encourage a change of course and it will likely only be when they start to encounter difficult times and have few options left that the shift will begin to happen.

The choice however does not need to be a binary one - Purposeful and Responsible Business or Profit? There is a growing body of evidence that purpose driven businesses do not need to impact profits but that over the longer term will in fact drive better and more sustainable returns. Michael Porter and Mark Kramer have long argued the need for a more sophisticated form of capitalism, one instilled with a social purpose and shared value that arises out of a deeper understanding of competition and economic value creation.[7] They write that shared value focuses companies on the right kind of profits - profits that create societal benefit rather than diminishes them. This is not philanthropy but self-interested behaviour to create economic value by creating shared value and the

survival of the fittest will still prevails, but market competition would benefit society in ways that have been lost.

June 2020

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