The Future of Business

Roundtable Summary

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About the organisers

The Smith School of Enterprise and the Environment is a leading international academic programme focused upon teaching, research, and engagement with enterprise on climate change and long-term environmental sustainability. It works with social enterprises, corporations, and governments; it seeks to encourage innovative solutions to the apparent challenges facing humanity over the coming decades; its strengths lie in environmental economics and policy, enterprise management, and financial markets and investment. The School has close ties with the physical and social sciences, including with the School of Geography and the Environment, the Environmental Change Institute, and the Saïd Business School.

Tomorrow's Company aims to shape the future of business success to build lasting value. Tomorrow's Company is a global think tank delivering value for business leaders and owners by addressing the systemic and behavioural questions of the business world. Tomorrow's Company defined the inclusive duties of directors for the UK's Companies Act 2006, its work on financial markets informed the creation of the UN PRI and its thought leadership is at the heart of the UK Stewardship Code and of the integrated reporting movement. Tomorrow's Company believes businesses can and should be a force for good and aims to inspire generations of business leaders to shape the way they do business.

Veratas is a think tank and consultancy focussed on helping businesses integrate social and environmental goals into the core of their operations. Moving beyond corporate social responsibility poses many challenges, which Veratas focuses on understanding to help businesses navigate this emerging area with greater success. Veratas was spun out of the University of Oxford in 2012 and is advised by the heads of Oxford's leading institutes working at the interface of business, society and the environment: Professor Gordon Clark, Director of the Smith School of Enterprise and the Environment, and Pamela Hartigan, Director of the Skoll Centre for Social Entrepreneurship.

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The assertion that the core responsibility of business is to maximise shareholder value within the confines of the law is increasingly being challenged. Businesses are gradually taking on wider societal and environmental responsibilities, which raises the question: what should be the goal of business, if not only profit maximisation? With the vast majority of businesses operating to maximise profits, it is unclear how a business might practically pursue other than financial goals. This raises further questions of how to measure non-financial performance, how to raise finance and what the legal implications are. In late 2013 the Smith School of Enterprise and the Environment hosted a roundtable at the University of Oxford to address these questions with leaders from business, academia and civil society.

The first panel session asked what the goal of business might be, if not profit maximisation. The panel juxtaposed the shareholder and stakeholder models, and outlined the challenges inherent in each. Although the stakeholder model encompasses a wider perspective of value it suffers from ambiguous trade-offs and indefinite accountability. Many seemed most comfortable with an extended idea of profit in which environmental and social impact become financially material. Participants stressed that leaders and employees currently struggle to reconcile their values with the incentives and pressures they face, especially from investors. One participant noted that their mandate to pursue non-financial goals only came from their profitability and growth.

The second panel covered the challenges of accounting for non-financial impact, especially raising the issues of indicators and subjectivity. Participants highlighted the challenges inherent in determining indicators and developing measurement protocols. Although businesses have become highly sophisticated at measuring their footprints, when it comes to non-financial results it seems they are not sure what to measure, how to measure it and how to translate that measurement into indicators that can be used alongside profit.

The third panel focused on the challenges involved with finding funding for organisations with non-financial goals. Financing for organisations with other-than financial goals currently requires the sacrifice of return by investors. Participants pointed to the rapid growth of the impact investing community and of new funding mechanisms as evidence of the increasing interest in investing for other than financial goals. However, although the impact investing industry is growing rapidly it remains marginal, and far from what would be needed to support all businesses to change their aims. One panellist suggested that, given that attendees are part of the system in question, asking what barriers we face to investing in social business personally would also be a productive approach.

The fourth panel focused on the regulatory aspect of change, and asked how regulation would need to change in order to facilitate a new focus for business. Panellists outlined the proliferation of legal forms that have emerged for impact-based companies. These legal forms, although currently niche, may form templates for a more mainstream vehicle in the future. Participants suggested that barriers to the mainstream adoption of goals other than profit maximisation are present particularly in the structure of corporate governance, which at present holds the company accountable only to shareholders. One panellist suggested enshrining public interest goals in company law as an avenue for broader accountability, and public interest was raised by a number of participants as a critical and underdeveloped aspect of corporate governance.

Most of the new investment and legal spaces identified in the panels are niche movements, and although heartening are qualitatively different to any infrastructure which might allow a macro-economic shift in corporate focus. The final panel discussed interventions that may contribute towards changing company goals across the system, which included normative and regulatory changes. Although existing infrastructure is expanding quickly, a great deal of work lies ahead on the road to transforming the business community into a more widely responsible social player.

The Smith School, Tomorrow's Company and Veratas would like to warmly thank our panellists and participants for bringing their ideas and enthusiasm to the event. Furthermore, we would like to thank the advisors, staff and volunteers who made the event possible.

Introduction

Background

The assertion that the core responsibility of business is to maximise shareholder value within the confines of the law is increasingly being challenged. Businesses are gradually taking on wider societal and environmental responsibilities, which raise the question: what should be the goal of business, if not only profit maximisation? This is not simply a normative question; it is also a question of what is necessary for businesses survival in an environment where resource scarcity, rising inequality and declining trust in business threatens the corporate licence to operate.

With the vast majority of businesses operating to maximise profits, it is unclear how and under what frameworks a business might operate if it were to pursue other than financial goals. How would such an organisation measure its performance, incentivise staff and raise finance?

The event

In late 2013 the Smith School of Enterprise and the Environment hosted a roundtable at the University of Oxford to address these questions with leaders from business, academia and civil society. In order to allow attendees to speak frankly the Chatham House Rule was applied and as such no names or affiliations are listed in this report. All content is the interpretation the authors took from the event. The following sections cover each of the five questions the roundtable addressed, namely:

1. What should be the goal of business, if not profit maximisation?
2. How should non-financial performance be measured?
3. How should non-profit maximising corporations attract finance?
4. What legislation needs to change to enable and support non-profit maximising businesses?
5. How can the focus of business be shifted away from profit maximisation?

Moving beyond social enterprise

Much of the discussion drew on attendees' experience with social enterprise, commonly defined as a commercial entity designed to address a specific social or environmental problem in the interest of society at large. While much can be learnt from this form of organisation, the focus of this event was intended to be much broader, considering the proposal that all businesses should balance economic, social and environmental concerns. The details of this balancing act were raised and debated by roundtable participants.

What should be the goal of business, if not profit maximisation?

Recognising that the vast majority of businesses are operating to maximise profits, this session aimed to shed light on the question of what goals a business might pursue other than profit, and under what frameworks.

The pursuit of non-financial goals is a radical position in an economy that places shareholder value maximisation as the primary purpose of business. The shareholder first approach asserts that a company exists to provide returns to shareholders, and is often cited as a central driver of profit maximising behaviour. A number of contrasting approaches to this dominant view exist. Stakeholder theory proposes that companies should seek to maximise benefits for all stakeholders, and is the main competitor to the shareholder maximisation approach. However, identifying and optimising for multiple performance metrics that correlate with the interests of different stakeholders has proven to problematic.

> *"The pursuit of non-financial goals is a radical position"*

Corporate Social Responsibility (CSR) appears to be another recognisable effort to expand business responsibilities. The CSR agenda has sought to refashion business operations, integrating bottom-line efficiencies, environmental impacts and social performance in an effort to marry monetary interests and wider societal concerns. The widespread currency of CSR and the goal of shareholder profit maximisation seem at loggerheads. However, it is widely argued that some social and environmental goals are intrinsically linked with business goals such as cost reduction and customer relations. From this perspective, CSR is far from a radical departure from profit maximisation.

Making the triple bottom line work

The concept of the Triple Bottom Line (TBL) has shaped many approaches to measuring financial, social and environmental performance and impact. These approaches are numerous and contested, and the question of how best to achieve efficient TBL performance is still unresolved. A key concern in developing robust TBL frameworks is the construction of context sensitive indicators that allow measurement within a specific sphere of operation and impact. Even with this attention to context companies will have to measure variables that have previously been ignored. The task of identifying, classifying and developing measurement processes in the face of institutional bias towards a single profit measure, will not be an easy or consistent one for many organisations and industries. Collaboration within and across industries and disciplines will be an important determinant of success. It was suggested that qualities such as intellectual diversity and curiosity, along with non-traditional partnerships could greatly improve the guidelines developed for any enterprise that sets out to locate and ultimately quantify non-financial parameters of success.

In this panel participants held a candid conversation about the constraints of corporate governance. Participants stressed that leaders and employees currently struggle to reconcile their values with the incentives and pressures they face, especially from investors. One participant noted that remaining profitable and increasing market share allowed their business to take the lead on social and environmental issues; that ability wouldn't exist if they weren't growing and returning good returns to shareholders.

How should non-financial performance be measured?

In light of alternatives to profit this session tackled a primary challenge for businesses moving beyond profit – the measurement of non-financial performance – and sought alternatives to profit as a performance indicator and governance tool.

Challenges to measuring non-financial performance

There are numerous challenges to be faced when measuring non-financial performance. Reconciling the large amounts of data from a variety of public and private sources, identifying which types of performance are material to specific industries and for different investors, and simplifying the indicators used are all key issues. Furthermore, the nature of non-financial performance is such that its measurement necessitates the inclusion of different community stakeholders. Integrated reporting was identified as a potential solution, but it requires the challenging translation of ESG performance into financial value.

> *"Although businesses are becoming increasingly adept at measuring their impact on the environment, they struggle to quantify this impact in financial terms"*

Although businesses are becoming increasingly adept at measuring their impact on the environment, they struggle to quantify this impact in financial terms. Participants note that the TBL perspective can make ESG attractive both as a risk management strategy and as a way to capitalise on opportunities. However, the case of natural capital and ecosystem services shows that significant challenges remain in finding the appropriate valuation tools, common metrics and corresponding market incentives.

Incentivising companies through the asset investment industry

As drivers of corporate decision-making, the investment community can play a crucial role in stimulating the measurement of non-financial performance by integrating ESG criteria into investment portfolios. Social impact investors increasingly use a company's risk profile to determine positive ESG impact. Indicators used in this profile can consist of exposure (systemic risks faced in the context of industry and country), preparedness (the ESG policies in place) and its performance (the number and severity of incidents and controversies).

Aligning ESG priorities involves forming coalitions of different groups that have an interest in having their savings managed in a responsible and transparent manner. When the interactions in the investment system become more streamlined, citizens' and employees' shared understandings of investment principles should reach the regulators and trustees. It's these rule-makers that can directly or indirectly engage asset managers, investors and eventually companies to improve their measurement of ESG and increase non-financial value.

The role of government

As long as ESG is sufficiently aligned with business drivers, the hope is that the interests of investors' clients will create enough pull to make non-financial measurement more widespread. However, where business interests – such as refusing to be transparent about incidents within one's operations – conflict with those of clients and consumers, or when channels of communication from rule-makers to citizens and employees are not improved, government may need to step in. This role may be to create a level playing field of ESG policies to allow corporate actors to engage in new market environments, such as exemplified by the REDD+ and US water fund schemes.

How should non-profit maximising corporations attract finance?

The pursuit of goals other than profit maximisation may limit the ability of business to attract investment. Currently, investors typically must be willing to bear decreased returns as a trade-off for social or environmental impact. New businesses that are set up with social or environmental goals prioritised above financial goals will not appeal to traditional investors whose primary interest is return on investment. If a public company shifts its focus from profit maximisation towards social and environmental gains, then its share price would likely suffer as shareholders moved their money to financially more productive investments. Obtaining debt finance poses similar problems. To date, corporates haven't directly confronted the choice between financial and non-financial goals, but rather attempted to balance different and often contradicting pressures while putting profit first. A number of critical obstacles remain if businesses are to change their orientation from one that is strictly financial to one that optimises for a wider set of performance outcomes.

> *"The social impact finance space has grown significantly over the last decade"*

A growing area

The discussion identified a number of non-traditional funding sources that may be accessed by organisations with broader goals. The social impact finance space has grown significantly over the last decade. Recent movements in the space have included the G8 holding an impact investment day to discuss innovations such as Social Impact Bonds, Goldman Sachs proposing a $250 million investment fund, and JP Morgan's consideration of a suite of impact-related investment vehicles worth $10 billion. Less traditional sources of capital such as crowd funding are also becoming significant players in financing social impact organisations. High net worth individuals have also shown interest in social impact investing, with many coming from entrepreneurial backgrounds and believing in the power of business to build solutions to social issues. New funding mechanisms are arising alongside new actors, such as social investment funds (e.g. Big Society Capital), the Social Impact Venture Capital Trust (awaiting tax relief determination), Private Placement between retail investors and companies, Bespoke by Social Issue (reducing reoffending in Peterborough), Social Impact Tax Relief, and the Advisory to Social Investors. However, this is still a nascent area, with UK social investment amounting to only £150-200 million each year, and most of this debt finance. By comparison charitable donations are about £10 billion each year.

Innovations in finance

The discussion outlined Social Impact Bonds, which allow entrepreneurs who can solve problems more efficiently than government to be rewarded with a portion of the public savings associated with their work. This involves calculating the cost of the problem to the public purse, and bringing government and social impact investors together to highlight synergistic opportunities. Such contracts allow impact investors and governments to share the savings associated with successful projects. Participants suggested that this type of investment can provide a sound financial return while receiving higher social buy-in than other asset classes.

Another innovation discussed was the Social Stock Exchange (SSE), which was set up for businesses that are 'profit satisfying' rather than profit maximising, allowing for more resources to be focussed on social and environmental impact. It caters for investors who want both social impact and financial return. SSE is a list of public companies that address social and/or environmental issues as a part of their performance mandate, and helps companies with appropriate missions to attract more ethically minded investors.

Expanding the pool of capital

Participants highlighted that while there is clearly a pool of capital available for more socially and environmentally focussed businesses this resource is currently a niche one. In the context of wider questions about the role of *all* business in generating impact, it remains strikingly evident that the markets and institutions that have been discussed are specialist entities and that financing on a scale that might support a macro-economic shift in business activity is completely absent. Institutional investors, despite their potential to play a major role, are still experimenting or reticent, and private investors show a reluctance to sacrifice profit for impact. A lack of broader interest led the discussion back to the sacrifice of return for impact, and raised questions about if and how traditional investors could be engaged to make such an investment choice.

One avenue for negotiating such engagement may lie in the fact that investors, like all humans, are not strictly rational. Investing is a 'heart and mind' task, and if wider impact organisations can engage effectively with the normative context of their investors they will find avenues for funding. Regulation also acts as an obstacle for investments on behalf of retail investors, as risk covenants become too high to invest easily in the space.

What legislation needs to change to enable and support non-profit maximising businesses?

The Community Interest Company

The discussion traversed both legislative changes and broader issues concerning company regulation and the uptake of alternative (social interest) legal forms. A major theme of the discussion was the benefits, drawbacks, and future potential of alternative corporate forms, particularly the Community Interest Company (CIC). As one panellist explained, the CIC can be seen as a legal innovation that enables businesses to give a credible, government-backed commitment to its stakeholders that the company operates for community-oriented purposes. It is also precluded from yielding control of the company or its assets in a way that would discontinue those purposes.

> *"A major theme of the discussion was the benefits, drawbacks, and future potential of alternative corporate forms"*

A number of challenges for CICs were identified. One drawback of the CIC was considered to be the rigidity of the asset cap requirement, and it was suggested that alternative definitions and means of specifying the asset cap could help CICs to grow. It was also felt that a corporation-centric bias in Whitehall sometimes results in the creation of new laws in a range of areas that are inappropriate for alternative corporate forms. It was thus suggested that rules regarding the impact assessments that Whitehall must undertake in respect of new legislation could be changed to require an assessment of the impact of new laws on CICs and other alternative corporate forms.

Other participants suggested reforms that could improve the uptake of CICs and make them more attractive. These included better marketing of the CIC structure; nudging new business registrants to consider incorporating as a CIC (as opposed to directing them to the normal corporate form by default); and providing information to simplify the process of CIC registration, such as template articles of association for CICs.

Noting that many other countries, including in continental Europe, lack CIC-like structures, it was suggested that the European Commission encourage other EU jurisdictions to develop such structures. An interim suggestion was to better promote the UK CIC to other EU countries, noting that companies in other EU countries are entitled to incorporate (including as a CIC) in the UK.

Alternative legal forms

Another participant compared and contrasted the UK CIC with other alternative corporate forms emerging in the US (including the B Corporation, L3C and Flexible Purpose Corporation) and France. The typical characteristics of these alternative "social interest" corporate forms include some combination of: a social purpose; a cap on the company's assets; the incorporation of stakeholder interests into company decision making; fair wages; ethical taxation (limitations on the use of tax loopholes); and transparent reporting. Such "social interest" companies were distinguished conceptually from "ethical companies", defined as ordinary corporations motivated primarily by profit but concerned to minimise their negative social and environmental impact. It was noted that one risk to social interest companies was their being "eaten" by large ethical companies. It was suggested that the continued use of robust, separate legal forms would be a way of ring-fencing the former from the latter, allowing healthy growth in both sectors. Moreover, international standard definitions (e.g. of "social interest"), categories and requirements (e.g. reporting) would help the development of the social interest sector, as would alternative tax treatments and tax incentives.

Promoting the public interest

There was much discussion about the role that the "public interest" should play in the decision-making of all companies — whether it should play a role at all and, if so, what the best legal mechanism to promote it would be, and how this could be enforced. One panellist suggested that directors' duties should be modified so to incorporate a negative obligation that directors be precluded from acting contrary to the public interest. One drawback of this approach is that, in the UK, only shareholders are empowered to bring legal actions to enforce directors' duties, and their interests will often diverge from that of the public at large. Unless alternative enforcement mechanisms were also to be introduced (e.g. a regulatory body who could bring actions on behalf of "the public interest"), there is a risk that such changes to directors' duties would be ineffective.

A final theme centred on changes to the laws regulating what investment managers say to their clients, at both the retail and institutional investor level. The current requirement of ensuring the "suitability" of investment products to clients refers only to financial suitability and incorporates nothing about social or environmental goals, impact or legacy investing. It was suggested a legal duty should be placed on fund managers to engage their clients in a conversation about responsible investment. This, it was thought, would be more effective than placing the obligation upstream, given the relative expertise and industry concentration in the fund management sector compared with institutional and retail investors.

This fascinating session yielded many valuable, practical reform options that the sector — and lawmakers — would do well to consider.

How can the focus of business be shifted away from profit maximisation?

Although progress has been made in measurement, financing and legislation, changes in focus have so far been marginal or confined to specific communities. This session asked what might be done to shift the focus of the business community at large away from profit maximisation.

Financial, social and environmental business impacts – towards new frameworks

> *"changes in focus have so far been marginal or confined to specific communities"*

The discussion broadly characterised some of the nuances of profit maximisation and impact. Notwithstanding the capacity of private commercial corporations to improve human wellbeing, it is widely recognised that the negative consequences of business often escape the scope of accounting instruments. This facilitates the illusion that all is well in the footprint of the profit maximising organization. The acknowledgment that not everything that counts is taken into account has spurred many companies to develop multifocal accounting optics to illuminate the social and environmental impacts of business. However, triple bottom line accounting standards do not necessarily signify a shift in focus away from profit maximisation, but an integration of new indicators into the profit calculating machinery supporting contemporary mainstream business models.

Socio-cultural factors – adjusting the framework

The practicalities of a shift towards non-financial indicators were discussed as being dependent on many factors. These included day-to-day managerial and planning practices, accounting standards and regulations, and normative guidelines and conventions. These dynamic factors combine a host of interdependent activities – implicitly and explicitly shaping important aspects of business. None are easily changed, but each provides an effective starting point. Managerial and planning practices oriented towards long-term and stakeholder concerns were cast as the way forward. Socially and environmentally focused accounting standards and regulatory regimes were also raised, with suggestions for continuous development in order to render social and environmental wellbeing tractable.

Finally, normative guidelines and conventions were discussed extensively. Panellists suggested that such normative positions should be critical for business, and should be discussed openly and rigorously. A number of participants stressed that normative positions may be an avenue for achieving serious impact with respect to business behaviour, investor sentiment and regulatory position.

December 2013

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