SUSTAINABLE CAPITALISM

Whether you subscribe to the notion of 'People, Planet, Profits', or the less-media friendly 'Triple Bottom Line' of financial, environmental, and social performance, critics of Corporate Social Responsibility (CSR) argue that the concept has served its purpose but no longer pushes the message of environmental and social awareness far enough. Glossy annual reports and photogenic websites illustrating the wonderful work of corporate-funded non-profit organizations around the world, may be very reassuring to stakeholders who want to see evidence of more conscious capitalism than the pursuit of profit at any cost. However, this project-based approach, it is argued, facilitates the development of 'window-dressing' strategies where the high visibility of PR-friendly projects may be used to divert attention from the lack of fundamental change in the way most corporations conduct business.

In February 2012, the non-profit arm of Generation Investment Management, LLP, (GenerationIM) a hedge-fund company started in 2004 by former US Vice-President Al Gore and ex-Goldman Sachs partner David Blood, issued a call-to-action manifesto for what the company calls 'Sustainable Capitalism'. With a core mission closely aligned to Gore's long-established advocacy of climate change and resource scarcity awareness, GenerationIM pursues an investment approach based on:

"..the idea that sustainability factors—economic, environmental, social and governance criteria—will drive a company's returns over the long term. By integrating sustainability issues with traditional analysis, we seek to provide superior investment returns."

The manifesto proposes several changes to the way the capitalist system currently works (or, from GenerationIM's perspective, fails to work), along with a call-to-action to achieve 'Sustainable Capitalism' by 2020. The first of five specific actions is to *"Identify and Incorporate Risks From Stranded Assets,"* which would require corporations to more accurately value items, such as carbon emissions, water usage, or local labor costs, where any significant changes in price (due either to market forces or federal legislation) would have a dramatically negative impact on bottom line profitability. This, the manifesto contends, would reveal many companies to be in a more financially precarious position than their current financial reporting might suggest.

The second action item is the requirement of *"Integrated Reporting"* of environmental, social, and governance (ESG) performance alongside mandated financial returns. This proposal has generated significant pushback from several large corporations who argue that it assumes of level of maturity in ESG data that isn't in place yet. As an alternative, advocates point to a requirement in South Africa for companies to either publish such an integrated report or to publish an explanation as to why they couldn't.

The third action item is to, *"End the Default Practice of Issuing Quarterly Earnings Guidance."* This is by no means a new proposal, but there is growing evidence of a willingness to give it serious consideration. In 2009, Paul Polman, the chief executive of Unilever (an Anglo-Dutch consumer goods company with brands ranging from Q-tips to Ben & Jerry's Ice Cream), stopped his company from publishing full financial results every quarter. Value Investor Warren Buffet has also adamantly refused to provide quarterly guidance at Berkshire Hathaway. Broader acceptance of this practice, however, will require a dramatic change in the inflexible expectations of Wall Street analysts who persist in offering their prognostications on a quarterly basis.

The fourth and fifth action items address the perceived problem of short-term management at the expense of longer-term sustainable value creation. If corporations were to, *"Align Compensation Structures with Long-Term Sustainable Performance"*, it is argued, there would be greater accountability for decisions made in the interests of stock price over corporate value. If a senior executive's compensation package includes stock options, he may be tempted to pay more attention to the price of that stock than the long-term ramifications of the strategic decisions made in support of that stock price. Financial rewards, the manifesto argues, should be paid out over the period during which the results are realized. This position has gained broad acceptance, but it also represents something of a conflict of interest for Al Gore, who exercised stock options for 59,000 shares as an Apple Director in January 2013 at a strike price of $7.475 a share ($441,025) for stock worth over $29 million.

The fifth action item is to, "Encourage Long-Term Investing With Loyalty-Driven Securities." With the average time period that investors hold a stock on the New York Stock Exchange falling from eight years in 1960 to as little as four months in 2010, this issue of 'short-termism' is seen as a major handicap to 'Sustainable Capitalism', with companies demonstrating a willingness to sacrifice research and development and capital reinvestment in favor of piling short-term results on top of more short-term results to keep the share price stable. However, there is clear evidence of corporate support in this area. Cosmetics company L'Oreal and Air Liquide have both offered shareholder bonuses for holding shares longer than a specified period of time. Technology companies, such as Zynga, LinkedIn, and Google, have taken a different approach by adopting dual-class voting shares that allow company founders to operate without the pressure to produce short-term results.

Critics argue that these action items represent nothing more than an attempt to burden an efficient capitalist model with political correctness. GenerationIM's decision to go beyond the more familiar 'green' or 'ethical' investment fund model and commit to these specific issues in their investment selection criteria, means that we may have to wait much longer for the promised larger returns of sustainable capitalism.

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Sources:

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