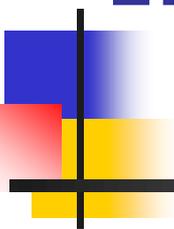
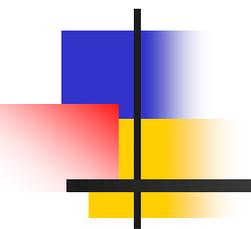


Responsible Business: The Evidence and the Implementation



Professor Alex Edmans, London Business School
www.alexedmans.com | @aedmans

ALTO Conference, March 2019



I. The Idea

What Is A Responsible Business?



- What is a responsible business?
- What is an irresponsible business?







DARAPRIM PRICE HIKE

COST OF TABLET



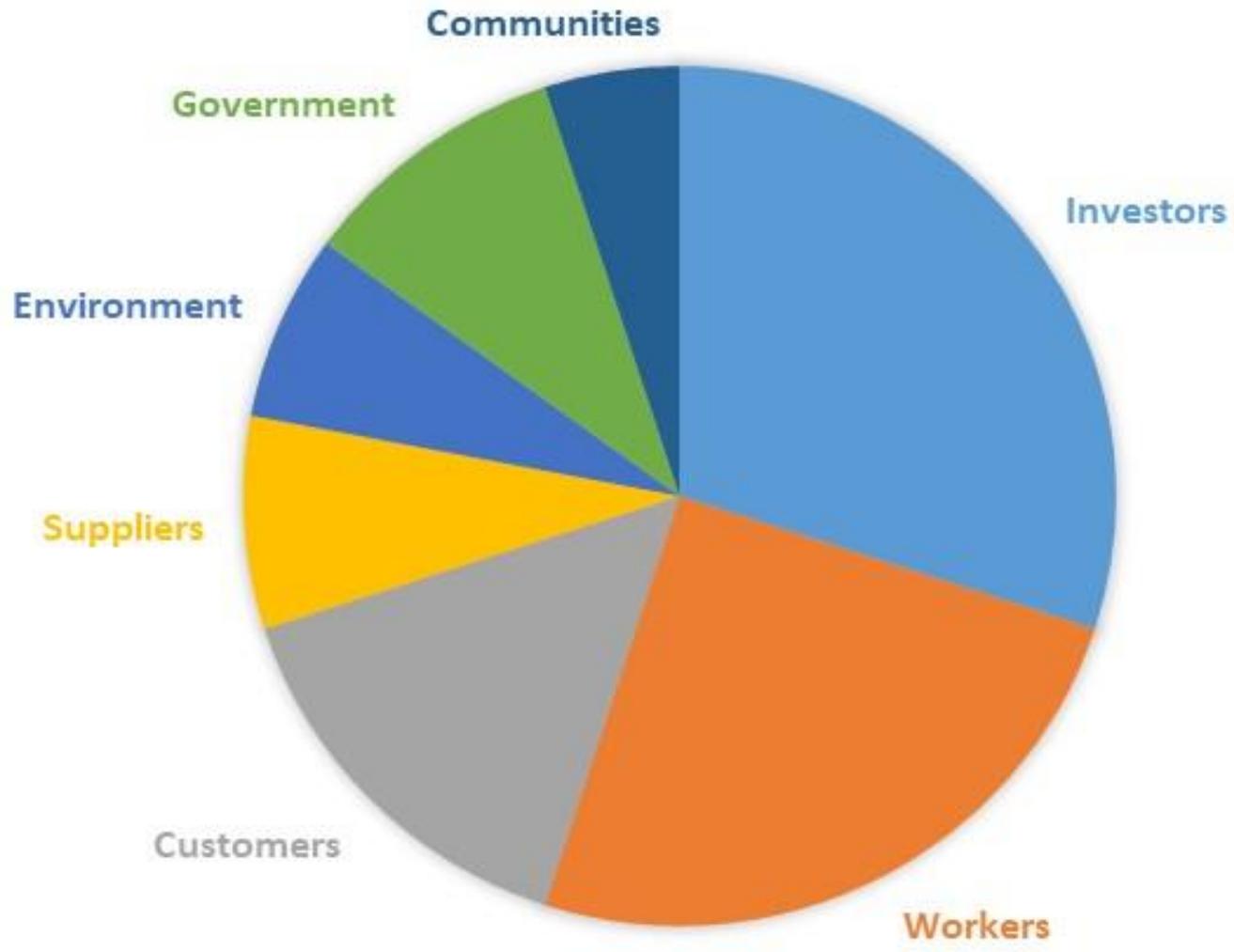
PREVIOUSLY
\$13.50

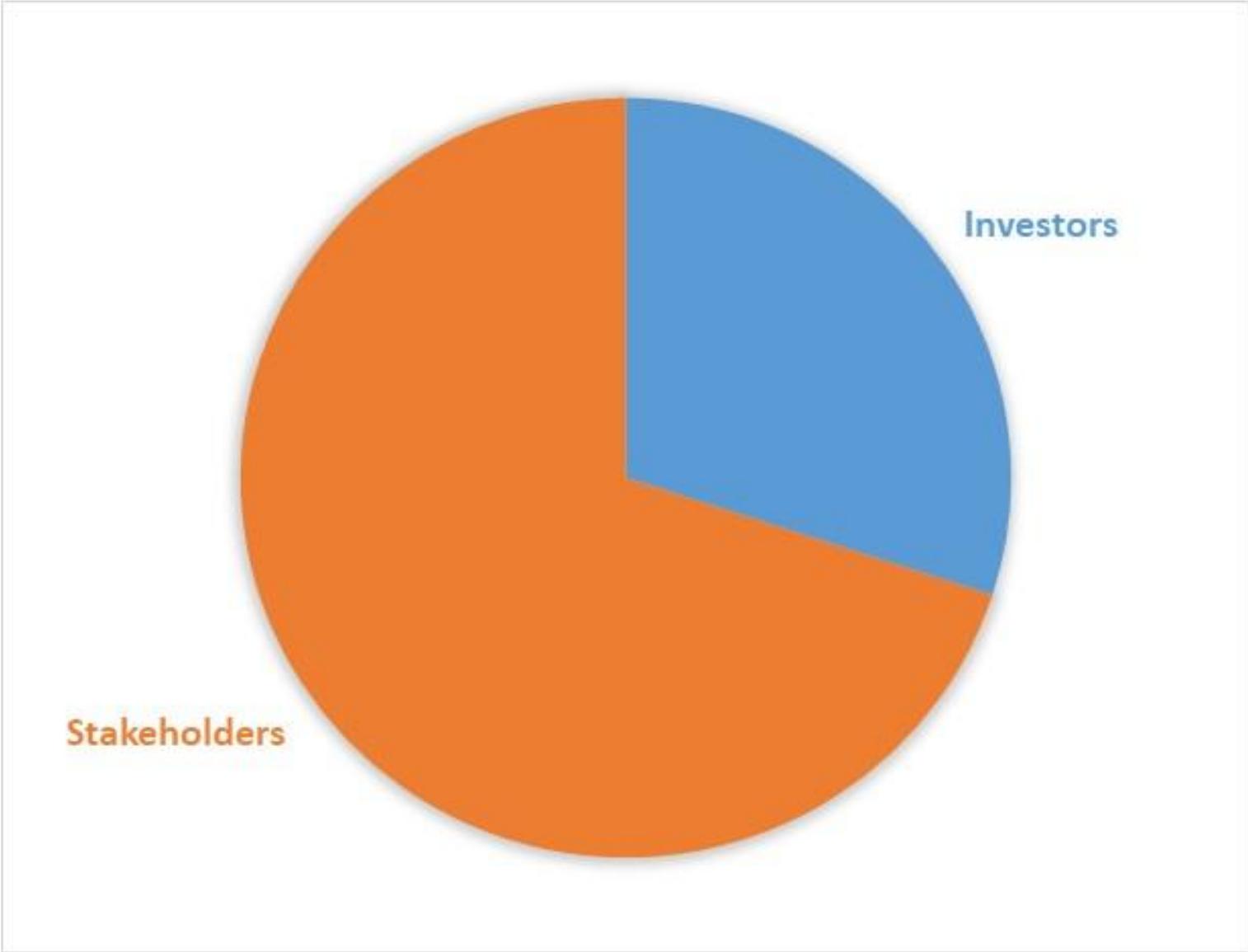


NOW
\$750

TURING
PHARMACEUTICALS







Stakeholders



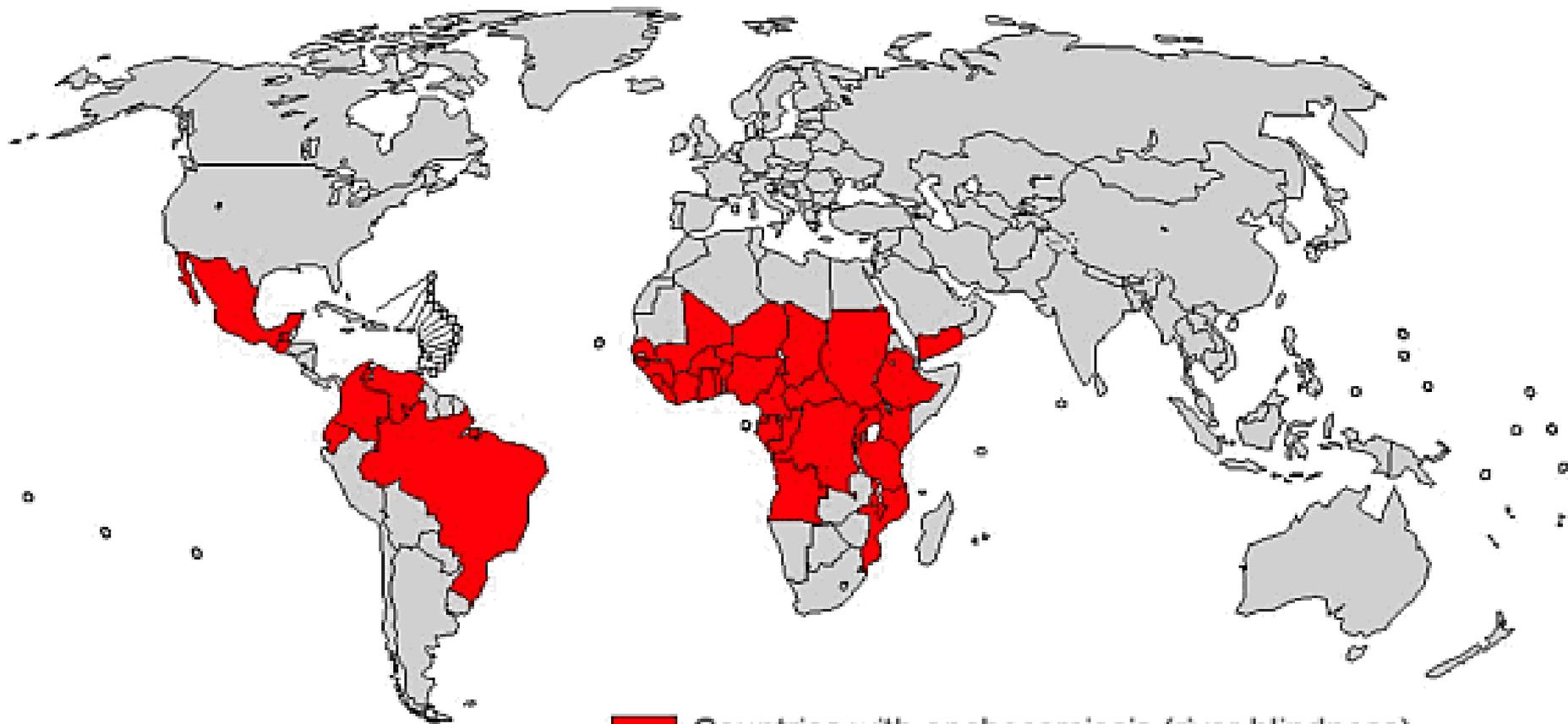
Investors











■ Countries with onchocerciasis (river blindness)







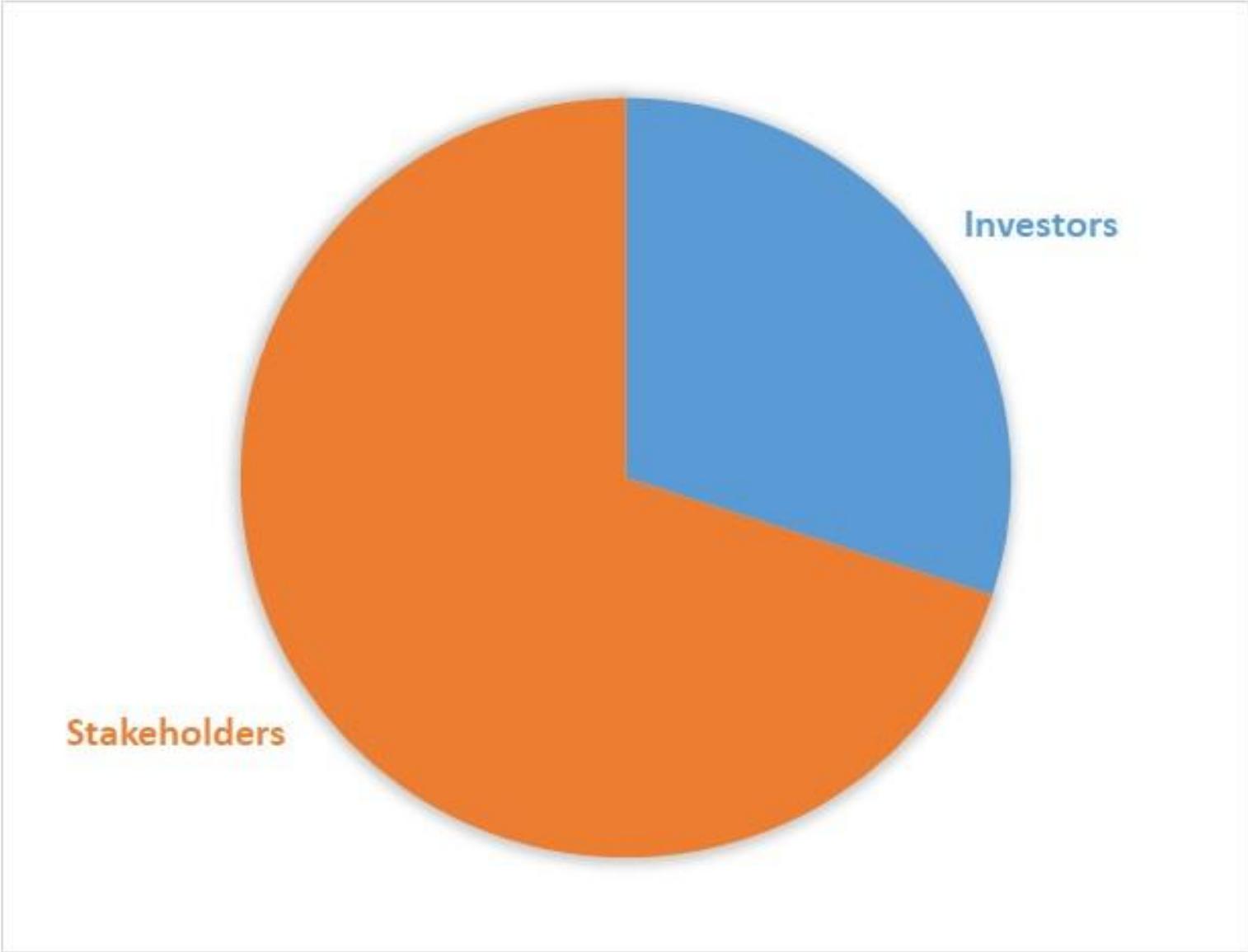
Mectizan Donation Program

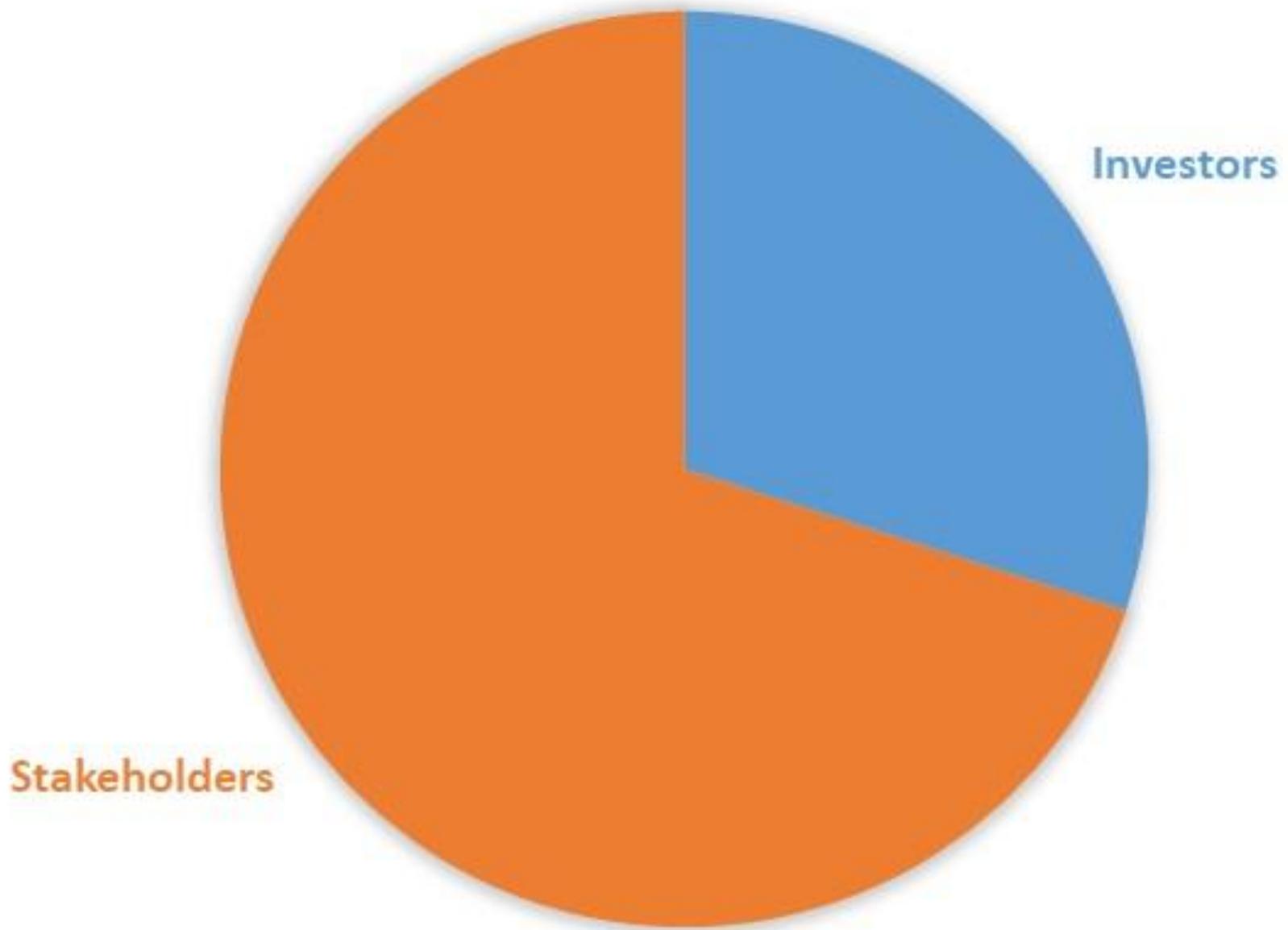
- “As much as needed, for as long as needed”
- Partnered with WHO, World Bank, UNICEF
- Longest-running disease-specific drug donation programme
- 2.7 billion treatments, 300 million people per year
- WHO has certified Columbia, Ecuador, Mexico, and Guatemala as having eliminated river blindness



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





What Is A Responsible Business?



- One that grows the pie, rather than just profits
 - Earns profits only as a result of serving 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

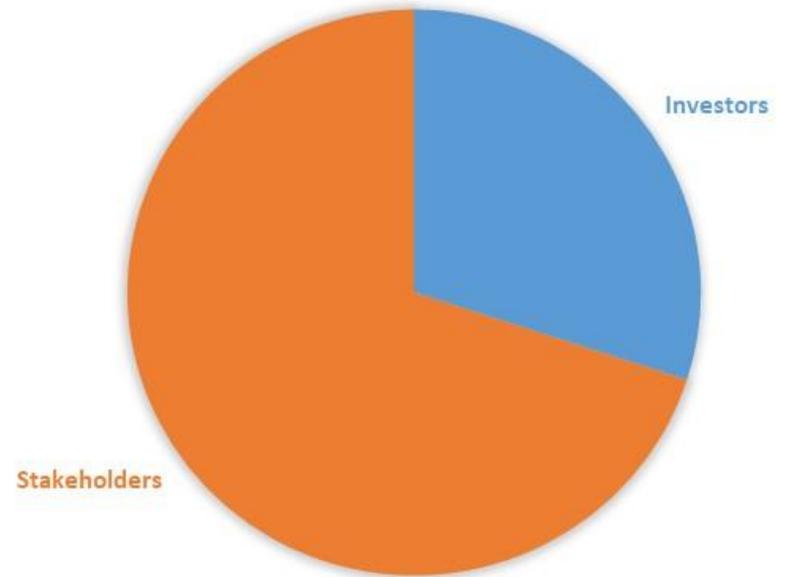
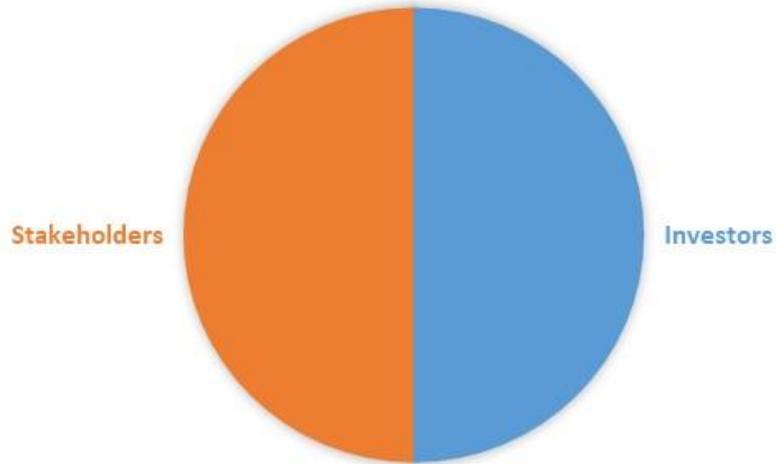


Instrumental vs. Intrinsic

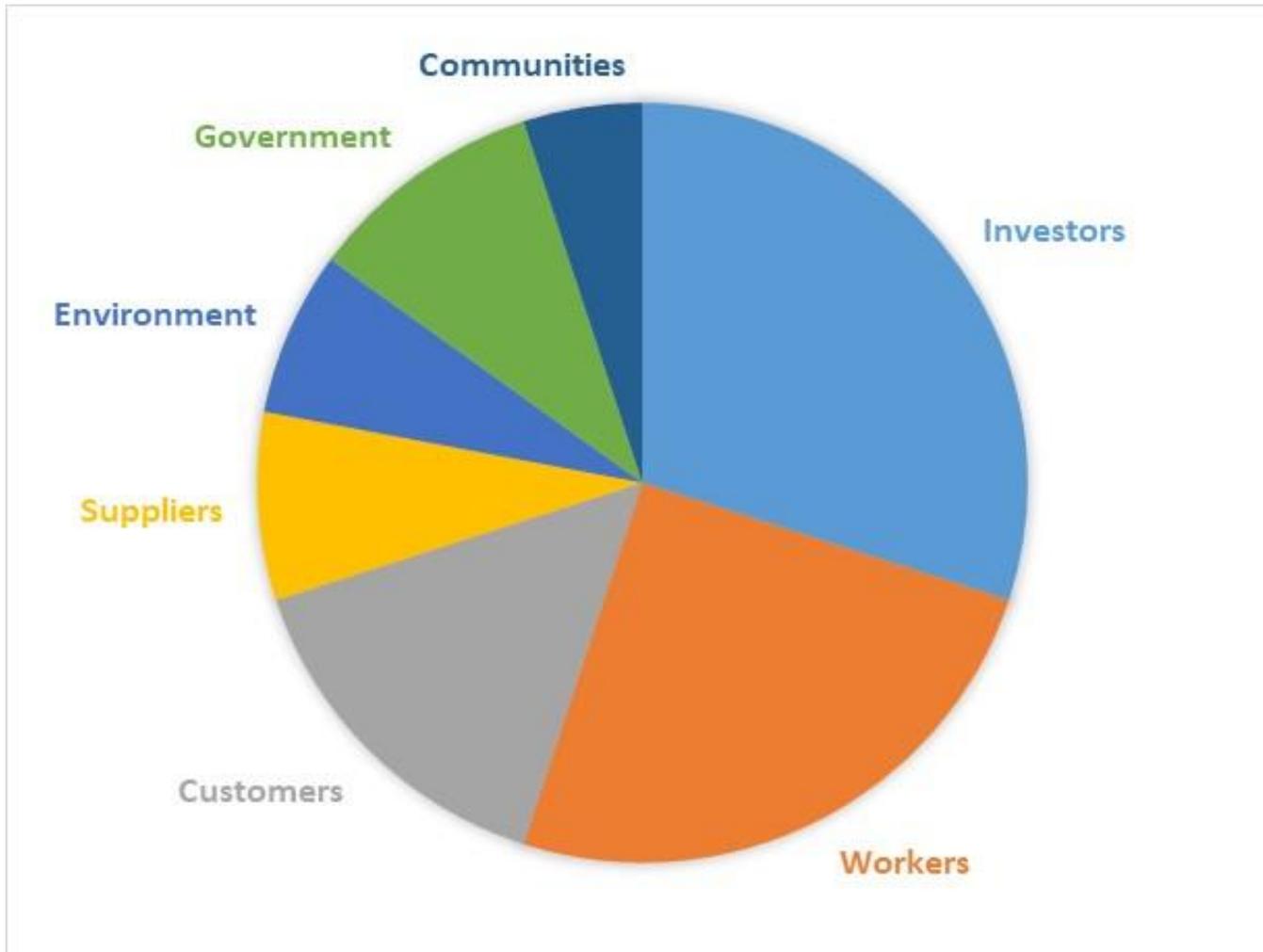
- Milton Friedman: “the social responsibility of business is to increase profits”
 - Stakeholders are important, but only as an *instrumental* way to increase profits
- Should Apple build a gym?
- A responsible business is *intrinsically* motivated by the desire to create value for society, and sees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

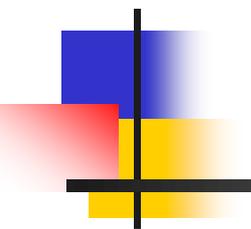


Profits vs. Externalities



Profits vs. Externalities





II. The Evidence

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

By [DAILY MAIL REPORTER](#)

UPDATED: 05:05, 25 September 2010



KEEPING UP WITH THE
KARDASHIANS





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}, 

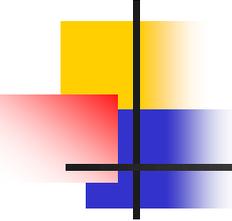
 [Show more](#)

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

[Get rights and conte](#)

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.



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 no-one has ever seen the study
- See TED talk, "What to Trust in a Post-Truth World"

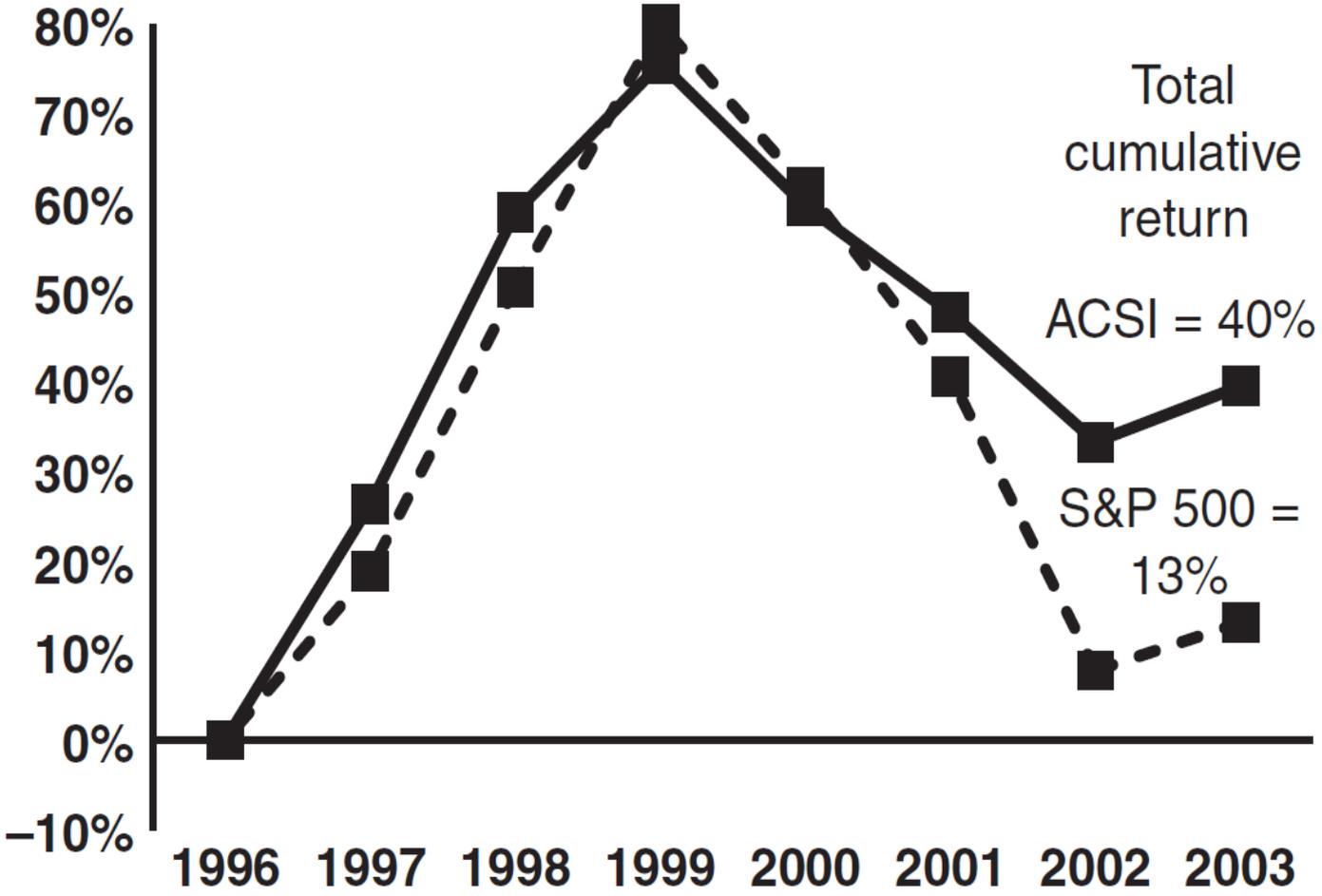
THE 100 BEST COMPANIES TO WORK FOR FORTUNE

GOOGLITES

Yes, the employees really are this happy.



The “100 Best Companies to Work For in America” beat their peers by 2.3-3.8%/year over 1984-2011 (89%-184% cumulative)



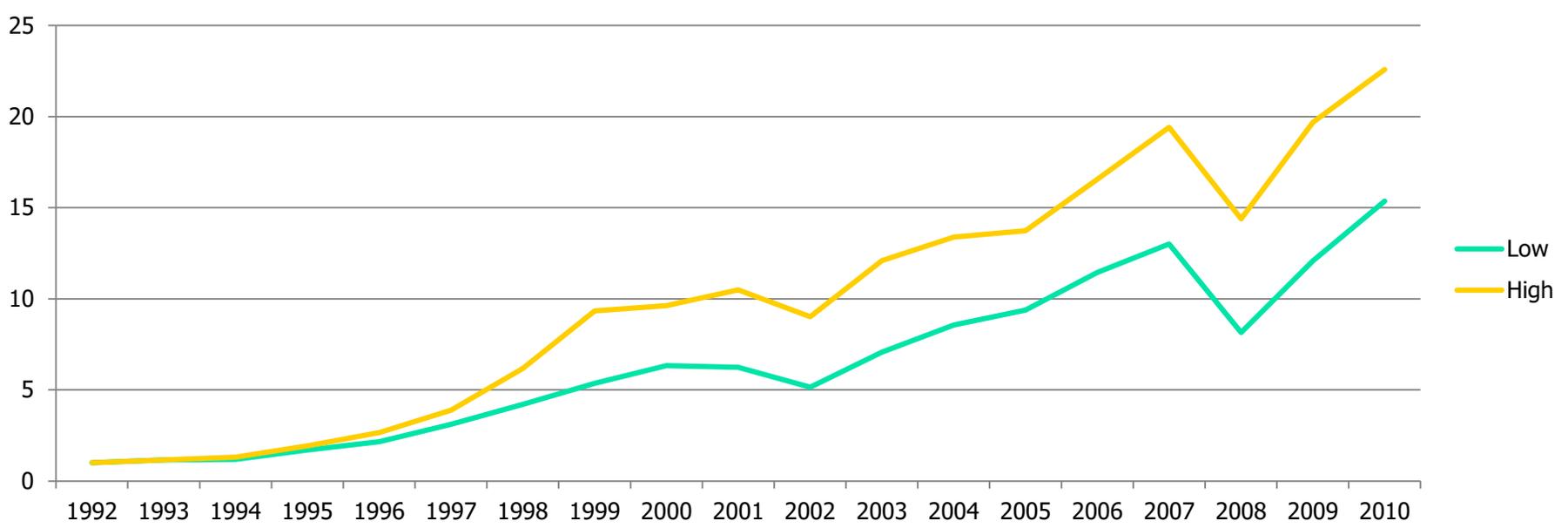
Fornell, Mithas, Morgeson, and Krishnan (2006)

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)

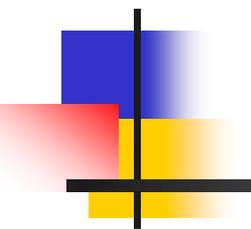
Derwall, Guenster, Bauer, and Koedijk (2005)



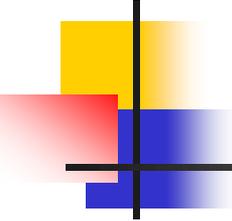
Innovest
Strategic Value Advisors



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

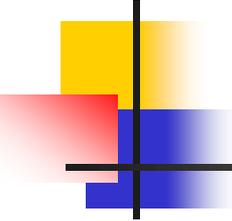


III. The Implementation



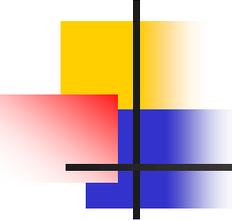
The Implementation

- How can you embed responsibility into your organisations?
- What are the challenges that you might face in doing so?



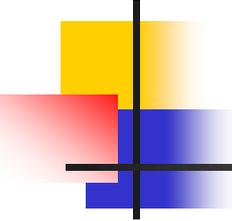
1. Excellence

- 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



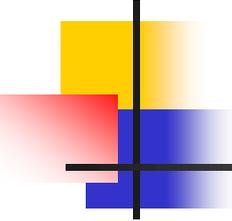
2. Purpose

- “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
- The glue that binds the organisation together
- Purposeful companies will make investments even if they don’t lead to predictable profits



2. Defining Purpose

- *Who* it exists for and *why* it exists
 - “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”
 - John Lewis: “ultimate purpose is the happiness of all its [employees] , through their worthwhile and satisfying employment in a successful business”



2. Defining Purpose

- 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
 - *Who*: Olam’s environmental focus, John Lewis’s employee focus are meaningful
 - *Why*: Costco provides “quality goods and services at the lowest possible prices”
- Principle of materiality

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

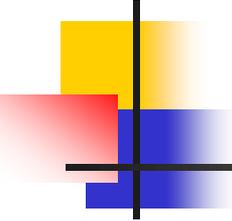
Human rights and community relations					
Access and affordability					
Customer welfare					
Data security and customer privacy					
Fair disclosure and labeling					
Fair marketing and advertising					

Human Capital

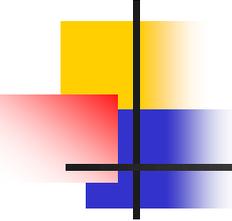
Labor relations					
Fair labor practices					
Employee health, safety and wellbeing					
Diversity and inclusion					
Compensation and benefits					
Recruitment, development and retention					

Sustainability Accounting Standards Board Materiality Map

2. The Importance of Materiality



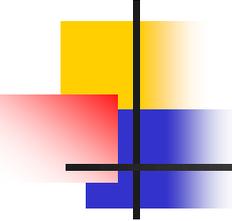
- Khan, Serafeim, and Yoon (2016):
 - High KLD scores slightly outperform, but not significant
 - Firms that score high on material issues and low on immaterial issues outperform by 4.83%/year
 - Reverse: -0.38%/year
 - Firms that score high on all issues outperform by 1.5%/year, insignificant



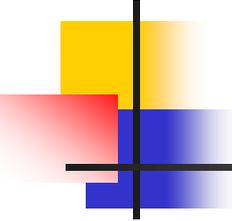
2. Living Purpose

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

3. Incentives for the Long Term



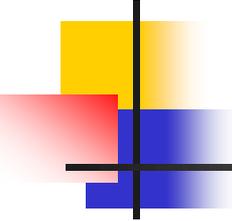
- Common focus is on the level of pay
 - But £5m pay is 0.06% of a £8b firm
- Much more important is the horizon of pay
 - Affects decisions, which have percentage point, not basis point, effects on firm value
 - See "Stop Making CEO Pay a Political Issue" (*Harvard Business Review*), <http://bit.ly/politicspay>;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



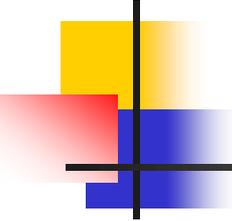
3. Incentives for the Long Term (cont'd)

- 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. From Employees to Colleagues

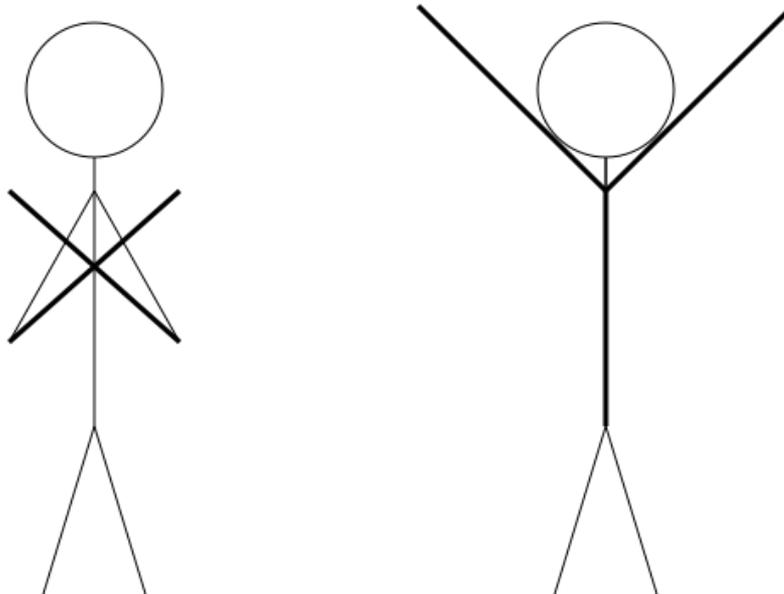


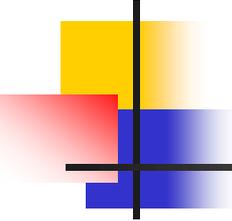
- Traditional view: workers are no different from any other factor of production
 - Effort-averse
 - Unintelligent
 - Motivated by money
- Scientific management (Taylor, 1911)
 - “Now one of the very first requirements for a man who is fit to handle pig iron as a regular occupation that he shall be so stupid and so phlegmatic that he more nearly resembles in his mental make-up the ox than any other type. ... He is so stupid that the word “percentage” has no meaning to him, and he must consequently be trained by a man more intelligent than himself”



4. Theory X and Theory Y

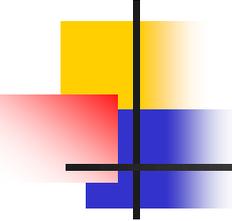
- Modern view: *human* resources not human *resources*
 - Intrinsically motivated
 - Intelligent
 - Driven to contribute or better themselves





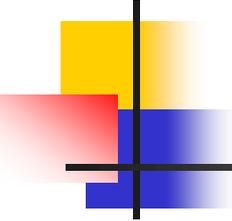
4. Theory X: Two Attitudes

- Free Disposal: viewing junior employee time as a disposal resource
 - Artificial internal deadlines
 - Unnecessary analyses. "Presentations are for us, not for the client"
 - Long hours seen as a rite of passage; can be compensated by salary
 - Culture of instant responses, always need to be on email
- Hierarchy
 - Valued by job title, not ability
 - Huge waste of employee initiative



4. Theory Y: Two Attitudes

- Partnership
 - Financial ownership: give shares to all employees
 - Task ownership: Japanese Andon system
- Investment
 - Giving opportunities, e.g. presenting at meetings
 - Mentorship: one-minute praisings and reprimands
 - Mental and physical wellness, e.g. UBS “100 days – 1 million steps”, Global Health Day



4. Colleagues: Reporting

- What gets measured gets done
 - Just because something can't be quantified doesn't mean it can't be measured
- Most firms already report employee engagement scores, diversity percentages, volunteer hours
- Potentially to think about
 - What areas of EE are strong / weak? Concrete plans for room for improvement
 - Communication and representation
 - Other dimensions of diversity
 - The output, rather than input, of volunteering

4. Colleagues: Reporting

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.

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

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.

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.

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.

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.

SUCCESSION PLANNING

ACHIEVED/
ONGOING

AIM By 2015, we aim to make internal appointments to 70% of our top 150 most senior vacancies.

RESPONSIBLE LEADERSHIP

NOT
ACHIEVED/
ONGOING

AIM Our top 100 business leaders will receive training on Responsible Leadership by 2015.

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.

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.

EXTEND EMPLOYEE HEALTH SERVICES

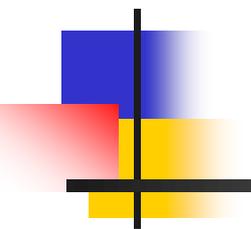
ACHIEVED/
ONGOING

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.

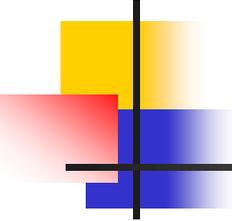
NUTRITIONAL LABELLING - EMPLOYEE CAFES

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).

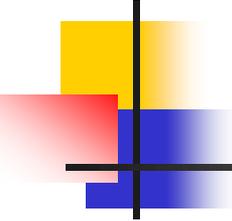


IV. Conclusion



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



Conclusion (cont'd)

- Further reading:
 - “Grow the Pie: How Enterprises Can Create Profit for Investors and Value for Society” (forthcoming book)
 - “The Social Responsibility of Business” TEDx talk, <http://bit.ly/csrtedx>