Fit for (Corporate) Purpose? Analyzing ESG issues in a fast-moving world

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Is the BRT rhetoric is backed up by deeds? Will it make a difference?

COVID-19 and its aftermath exposed deep-seated problems of racial inequality. The Test of Corporate Purpose (TCP) was designed to evaluate how companies responded to these epochal events. To analyze company behavior, the project required current information on fast-moving events. TCP relied on Truvalue Labs' technology-based ESG analysis for timely analysis of material issues related to COVID-19 and inequality.

Shareholder Value

Over the past 50 years, globalization of trade and finance and government deregulation have contributed to corporations becoming increasingly powerful – institutions with global reach in a world governed by nation states. In the realm of finance, these developments coincided with the rise of shareholder capitalism, with its singular focus on maximizing shareholder value.

This worldview is expressed in Friedman's 1970 article. More polemic than economic analysis, Friedman's manifesto was a response to nascent shareholder activism. Campaign GM submitted proxy proposals aimed at creating accountability by adding directors representing external stakeholders and creating a shareholder committee on corporate responsibility. This proxy battle inaugurated shareholder engagement, today a core ESG strategy. It also provoked a backlash.

In the article, Friedman counterposed the interests of shareholders with those of society: "The use of the cloak of social responsibility, and the nonsense spoken in its name by influential and prestigious businessmen, does clearly harm the foundations of a free society." Ultimately, "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…"

Friedman is silent about who gets to play, who sets the rules and who referees the "game." The argument is rooted in the fantasy world of perfectly competitive markets – free from market failure caused by externalities and corporate capture of the political process – where outcomes magically reward all participants fairly.

This paradigm has contributed to the financialization of the economy, widening unequal distributions of wealth and income, a narrow definition of fiduciary duty and a myopic focus on short-term results by corporate management. It comes at the expense of long-term investment decisions, ignores externalities, and discounts the impacts of today's actions on the quality of life of future generations.

Milton's Paradise Lost: Corporate Purpose and Stakeholder Value

Stakeholder capitalism is the counterpoint to shareholder primacy. After 50 years of shareholder capitalism, with the convergence of climate change, a pandemic and systemic inequality, it is inadequate for resolving fundamental challenges. Indeed, it is part of the problem.

In recent years, Robert Eccles and others have advocated to make *corporate purpose* the basis for integrating the interests of corporate stakeholders alongside those of shareholders. A recent publication provides guidance for boards to "put purpose *intent* into *practice*, demonstrating how purpose informs strategic choices and delivers value for a range of stakeholders."

The premise is that the "the purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems." Purpose is existential – defining *why* a corporation exists – preceding the articulation of values, mission and vision. It also drives the formulation of strategy, not *vice versa*. This view has credence in Europe but has been anathema in the U.S. until recently.

ESG Research: The linchpin between companies and investors

ESG investors seek accountability on sustainability issues at companies in their portfolios. ESG research is the connective tissue in this process, providing information and analysis linking corporate behavior with sustainability objectives. Connecting the dots on behavior, impact and investment effectively incorporates the interests of other stakeholders into shareholder capitalism.

With ESG-related data growing exponentially, AI is an essential tool for understanding what is happening at companies, which issues matter most, and why. Technology-driven ESG research measures stakeholder perspectives in real time to form a current view of the sustainability profile of a company derived from its digital footprint. In contrast, traditional ESG analysts operate with time lags ranging from weeks for event analysis to a year (or more) for ratings. A large team of analysts would need months to review the 115,000+ sources Truvalue Labs monitors daily.

Surging demand for ESG investment has focused attention on the lack of currency and salience in traditional ESG research. Today, technology is a prerequisite for tracking and analyzing ESG issues. The TCP project substantiates that Truvalue Labs' AI-driven ESG research is fit for purpose in our fast-moving, data-rich world.