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## Key concepts and terms in corporate sustainability strategy, sustainable finance, and sustainability reporting

**Rod Lohin**

EXECUTIVE DIRECTOR

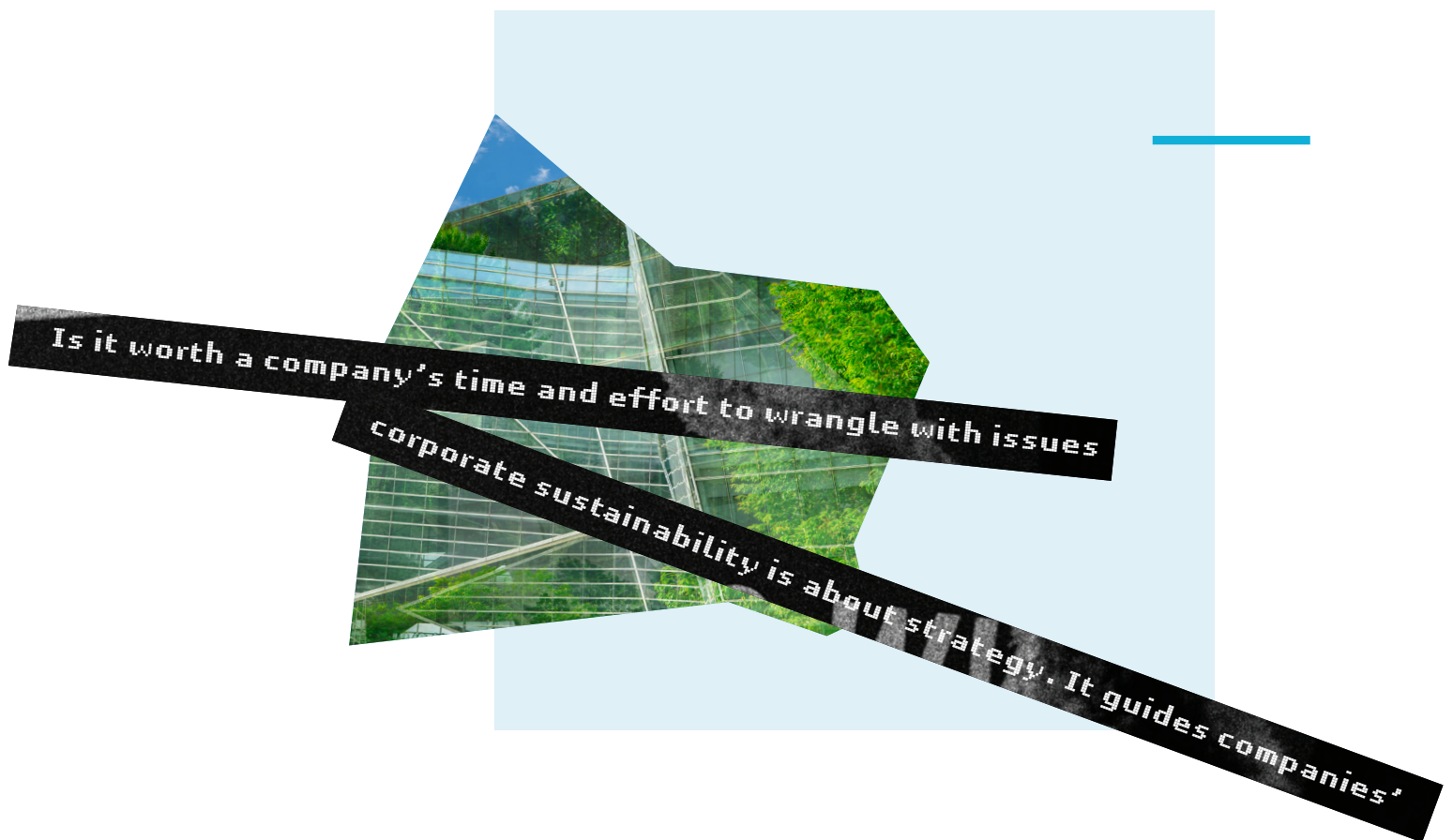
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## About the Canadian Centre for the Purpose of the Corporation

The Canadian Centre for the Purpose of the Corporation (the Centre) is an initiative of Navigator, Canada's leading high-stakes strategic advisory and communications firm. The Centre's mission is to equip Canadian businesses and organizations with insights, tools and support as they work to redefine and strengthen both the scope of their purpose and the contributions they make more broadly to society. The Centre releases regular analysis and guidance for business based on the expectations of Canadians. These insights inform the design of tailor-made strategic solutions for businesses and organizations to define, advance and implement their purpose. The Centre is led by Navigator Managing Principal Graham Fox, alongside a panel of experts in policy, governance, business, law, communications, equity and diversity, sustainability and social responsibility.





## Foreword

At a time when public expectations of corporations are rapidly changing and the pressures to emphasize sustainability and purpose grow, the Canadian Centre for the Purpose of the Corporation (the Centre) exists to help CEOs and boards of directors stay in the know and navigate those unfamiliar waters. In addition to playing an advisory role to organizations, the Centre provides unique Canadian thought leadership through surveys and research reports.

In this latest research report titled “Key concepts and terms in corporate sustainability strategy, sustainable finance, and sustainability reporting,” Rod Lohin, Executive Director at the Rotman School of Management, tracks the history of the themes and concepts that inform our current understanding of corporate sustainability. Challenging the “shareholder model” approach to capitalism, Lohin’s report charts the evolution of sustainability in the domains of strategy, finance and reporting.

Noting that the concepts of corporate sustainability and sustainable finance are more mature and better understood than corporate purpose, Lohin argues the concept is nevertheless a promising way for corporate leaders to anchor their strategy. While not yet conclusive, early evidence suggests corporate purpose is an effective way to articulate more clearly a corporation’s role in society and to make governance and strategic decisions that better align with its *raison d’être*.

Ultimately, it is up to each company’s leadership team to find the right path, but acting sooner than later in establishing its purpose beyond financial gains may go a long way to ensure a corporation’s sustainability. As Lohin puts it, “In this time of uncertainty, environmental, social and political strife, and the spectre of war, it is possible that early adopters of purposefulness will be rewarded for their clarity and commitment beyond economic prosperity.”

**Graham Fox**

Executive Chair, Canadian Centre for the Purpose of the Corporation



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Today, companies are increasingly expected to be responsible or sustainable or to explain their purpose beyond economic prosperity.

For many business leaders this is unfamiliar territory. There are so many issues, acronyms and buzzwords in sustainability, like CSR, ESG and SDGs. There are many more players to consider: consumers, investors, regulators and communities, among others.

Is it worth a company's time and effort to wrangle with issues and players that complicate the already tricky job of making a profit, especially in times of high inflation, supply chain woes and war?

The answer is becoming clearer. A growing body of evidence shows the promise of two approaches — corporate sustainability strategy and sustainable finance — have been delivered over the past 20 or 30 years. A wide array of research shows they are good for business and better for society, too. Sustainability reporting, a third approach that has developed quickly in the last decade or so, also appears to be delivering value. However, the concept of corporate purpose beyond profit is a newer addition to the conversation on corporate sustainability. While it has all the promise of these other approaches, so far there are only very early indications of its value to companies and society.

For leaders who want to learn the essentials about corporate sustainability, sustainable finance and reporting, this briefing explains key concepts and terms and how they have evolved. It also explores recent trends, including how companies are reflecting on their purpose beyond profit.

## What are we talking about?

All disciplines and industries have their own specialized terms and acronyms, and the world of corporate sustainability is no exception. Broadly speaking, there are three domains that are important to understand:

1. **Strategy:** The form and purpose of companies and how they relate to society and social issues.
2. **Finance:** How financial and investment decisions relate to society or social issues.
3. **Reporting:** Reporting standards, systems and procedures relating to actual social and environmental impact.



There are also many ideas and terms relating to internal sustainability controls (sometimes known as environmental health and safety and/or equity, diversity and inclusion policies and tracking systems). These are important to be considered in the context of sustainability issues, but as there are many, many variants based on industry and operating environment and they tend to be more familiar to managers, we will not dwell on them here.

Lastly, it should be clear that these domains sometimes overlap. For company leaders, the most important thing to know is which domain they are dealing with, as they are easily confused.

## **1. Strategy: The form and purpose of companies and how they relate to society and social issues**

To begin, it's helpful to revisit how the form and purpose of companies have evolved over time. In short, the form of companies has evolved from being small, informal local structures to being massive, hugely influential global institutions. Their purpose, which initially was to solve challenges about ownership and liabilities, has also changed over time. Only very recently has it been argued that the purpose of companies is to maximize financial returns for the benefit of their shareholders, without reference to other "stakeholders" or the societies in which they operate. However, there remains much debate about the purpose of business and its potential to contribute positively to society.

During the late Middle Ages and into the Renaissance, most businesses were what are now called owner-operated proprietorships or partnerships. These informal structures principally granted ownership rights. However, there were several drawbacks. In particular, owners were individually or jointly liable for all debts, risks or losses, as were their heirs.

In the early modern era (1600s-1700s), "chartered companies" arose. A charter, granted by the state, outlined the company's rights and responsibilities and an expectation that it operated for the "common wealth" (at this time meaning the expansion of the state into new regions to be exploited). Crucially, chartered companies limited the risks and liabilities of the owners to the size of their investment. The most prominent examples were colonial ventures such as the Dutch East India Co., the East India Co. and the Hudson's Bay Co.

Over time, the corporation structure formalized and was increasingly reflected in commercial, financial and legal systems. It rapidly spread across developed economies along with the growth of public and private capital markets (thus,



“capitalism”). Many larger and larger corporations flourished during the Industrial Revolution and into the early 20th century. Some of the most prominent were led by owner-operators, later (in the U.S. context) dubbed “robber barons” like Andrew Carnegie (steel) or J.D. Rockefeller (oil).

By the 1930s, in a wave of regulation brought on by the Great Depression, the scale and complexity of businesses grew to such an extent that owner-operators were largely replaced. Professional corporate leaders (many of whom were trained in business schools in the emerging discipline of management) took the reins from owner-operators during a period sometimes referred to as “managerial capitalism.”

By the 1970s, in the context of lower corporate profits, high inflation, surging energy costs and unemployment, the influence of the financial markets grew. Free-market theorists argued that professional managers were at fault for lower profits and that the needs of investors (shareholders) should reign supreme. For example, leading scholars Michael Jensen and William H. Meckling argued that there was a misalignment between the interests of shareholders and professional managers, in effect that “owners were getting short shrift from professional managers, who enhanced their own financial well-being rather than that of the shareholders” (Martin 2010). Their paper “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” (1976), published in the *Journal of Financial Economics*, has since become the most widely cited business journal article of all time.

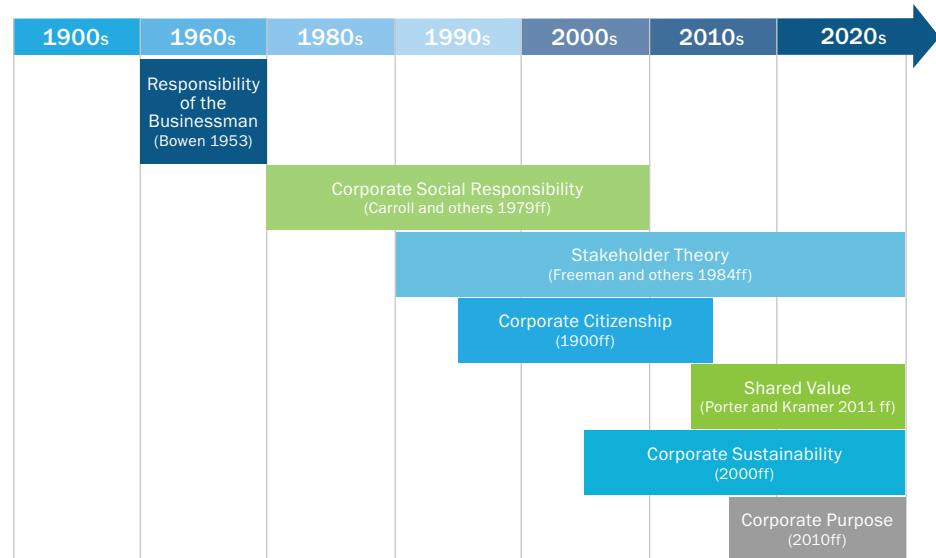
The wide acceptance of this theory of the firm ushered in a new period sometimes called “shareholder capitalism,” in which the purpose of the corporation was understood to be for the benefit of shareholders above all else. To some extent this view remains the dominant one, particularly among the current generation of business leaders, as well as established economists and business scholars.

### **The rise of alternative theories of the corporation**

There have long been criticisms of companies and the economic system that ultimately became known as capitalism. From medieval anti-usury laws, to protests against industrialization by the Luddites in the early 1800s, to the views of radical political economists Marx and Engel, there has been no shortage of flaws or shortcomings pointed out in the forms, purpose and behaviour of companies. This section focuses on recent alternative theories about the corporation, specifically those that attempt to better describe how business relates to society and social issues.



Examples of these theories and related terms appear in the chart below based on when they came into use and how they are currently perceived by thought leaders and practitioners.



Source: Lohin 2022

These theories and models are all attempts to add wider context to the understanding of the role of companies and how they are situated relative to other elements of our societies. In essence, they all argue that companies exist in a broader social and environmental context that must be understood to ensure their success and survival, and, perhaps, for the survival of capitalism itself. Some models focus on the role of the individual, in particular the “business leader;” some focus on the network of people who interact with and are affected by the company (stakeholders); and some highlight the role of companies themselves and how they set priorities, make decisions and act.

Here are a few of the most prominent theories and their associated models.

In 1953, Howard R. Bowen published “The Social Responsibilities of the Businessman,” in which he asks (clearly excluding women):

*“Are businessmen, by virtue of their strategic position and their considerable decision-making power, obligated to consider social consequences when making their private decisions? If so, do they have social responsibilities that transcend obligations to owners or stockholders? The answer to both these questions is clearly yes.”*

Beyond obvious objections to the sexism here, not all agreed with Bowen’s proposed broadening of responsibilities. In 1970, American economist Milton Friedman argued that social responsibility was a dangerous path towards, in effect, communism (foreshadowing more recent criticisms). Instead, he held that:



*"[T]he doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why, in my book "Capitalism and Freedom," I have called it a "fundamentally subversive doctrine" in a free society, and have said that in such a society, "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."*

(Friedman 1970)

Nevertheless, other management scholars began to explore corporate responsibility, including management guru Peter F. Drucker, who wrote:

*"Leaders in every single institution and in every single sector ... have two responsibilities. They are responsible and accountable for the performance of their institutions, and that requires them and their institutions to be concentrated, focused, limited. They are responsible also, however, for the community as a whole."*

(Quoted in Hesselbein 2010)

The work of Archie B. Carroll cemented the idea of corporate social responsibility. Carroll wrote that corporate social responsibility "encompassed the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organizations at a given point in time" (Carroll 1979ff).

**Here is a diagram of his concept, which has been updated several times:**



Source: Carroll 2016





R. Edward Freeman expanded on this idea of dual or even multiple responsibilities in “Strategic Management: A Stakeholder Approach,” in which companies were understood to be accountable to many stakeholders (Freeman 1984, revised 2010). Stakeholders are people who are directly or indirectly affected by an organization’s policies and actions. They include internal stakeholders (such as employees, customers and shareholders), and external stakeholders (such as the general public, activist groups and communities). Freeman argued that business leaders must be cognizant of the interests of a range of stakeholders to make the best decisions for the company. This work was instrumental to the later concept of corporate purpose, in the sense of a purpose that is not defined solely by profit but also includes deliberate commitments to making the world a better place in social or environmental terms.

### Stakeholders’\* View of the Firm



\* Stakeholder = Any group or individual who can affect or is affected by the achievement of the firm’s objectives. The groups listed here are examples of categories of stakeholders.

Source: Friedman 1984

The term “corporate citizenship” arose in the late 1980s as a way to express the idea companies should behave in a way that is consistent with both the rights and responsibilities that are conferred by the status of the corporation as an individual. Companies had already taken advantage of the rights of this status (such as their ability to operate as a legal entity with limited liability) but corporate citizenship made explicit the expectation that companies should also be responsible by contributing to society in positive ways, notably through philanthropy and by better reflecting the needs of their communities. In many ways corporate citizenship is synonymous with corporate social responsibility and the two terms are often used interchangeably.

The term corporate social responsibility (CSR) remains the most commonly used term in scholarly writing but has more recently been seen by professionals as



outmoded. It can be seen as an extension of Bowen and Carroll's (and others') work to broaden the issues that companies should consider when making choices.

In 2011, Harvard strategy guru Michael Porter and his practitioner colleague Mark Kramer attempted to reconcile the economic and social imperatives of the corporate profit motive and corporate social responsibility through what they term "creating shared value (CSV)." In their view, shared value means:

***"policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress."***

*(Porter and Kramer 2011)*

They describe the differences between CSR and shared values as follows:



*Source: Porter and Kramer*

By the late 2000s and into the 2010s, CSR began to be supplanted by the term "corporate sustainability" or just "sustainability." This term attempts to broaden the conversation even further by making explicit the idea that companies must consider their long-term viability, particularly with respect to their context in terms of environmental issues (although among practitioners there is an important, if implied, set of social issues, too). However, the term can sometimes be understood by those less aware of these nuances to mean the economic well-being of the company only, that is, its financial sustainability.

But what was considered a valid sustainability issue (social or environmental) remained somewhat unclear. To resolve this for a range of societal actors



(governments, NGOs, businesses and citizens), the United Nations developed its Agenda for Sustainable Development (2015), which “provides a shared blueprint for peace and prosperity for people and the planet, now and into the future.” A key part of the agenda was an agreement on 17 sustainable development goals (SDGs) to help create a common language for, and support co-ordination of, sustainability objectives. These objectives included:



Since the creation of the SDGs, many companies have expressed their social and environmental objectives in these terms, and they are increasingly commonly used as a framework for reporting on activities and achievements. (More about this later.)

In August 2019, the Business Roundtable (an association of major U.S. companies) updated its Statement on the Purpose of a Corporation. Its previous statement from 1997 reflected shareholder theory perfectly: “The principal objective of a business enterprise is to generate economic returns to its owners.” But in 2019, its new statement shifted to a stakeholder view:

***“While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:***

- ***Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.***
- ***Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.***



- *Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.*
- *Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.*
- *Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.”*

In late 2019, the World Economic Forum (WEF) released its Davos Manifesto, stating:

***“The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large. The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company.”***

(WEF 2019)

These theories and commitments seem to be gathering momentum and, at least to some degree, are converging on a broader sense of corporate purpose to create social or environmental value beyond financial performance, and responsibilities to stakeholders (and, in particular, beyond shareholders).

In common business parlance, however, purpose is rarely considered. It could arguably be related to more commonly known business terms such as a company’s mission, vision, values, strategic intent or other objectives. But in this context, purpose tends to suggest a broader role in society and a commitment to a long-term reason for a company’s being that goes beyond financial success.

In our own work at the Lee-Chin Institute, we’ve recently done a review of emerging academic and practitioner research on corporate purpose. To start, definitions vary widely. Here are two examples:

***“[We define] organizational purpose as: an organization’s meaningful and enduring reason to exist that aligns with long-term financial performance, provides a clear context for daily decision making, and unifies and motivates relevant stakeholders. . . There are five fundamental characteristics that underpin this definition: 1) a transcendent, meaningful***



*reason why an organization exists; 2) a core attribute of the organizational identity; 3) an alignment with long-term financial performance; 4) a clear context that guides daily decision making; and 5) a unifying and motivating force for relevant stakeholders.”*

*(Hurth, Ebert & Prabhu, 2018)*

*“Corporate purpose is rapidly becoming a global phenomenon — only no one really understands what it means. Milton Friedman’s notion that a firm’s purpose is “just making money” is becoming discredited, but no succinct alternative has replaced it. . . So, let me be clear about what corporate purpose should be — “to produce profitable solutions to the problems of people and planet, and not to profit from producing problems for people or planet.” It is about producing solutions, doing so profitably not just philanthropically, and measuring fair — not fake — profits. We are used to business focusing on one interest group in society: shareholders. That simply cannot be right, fair or efficient. Instead, business should be structured around the question why it exists, what it is there to do, and what it aspires to become — namely its purpose — and everything should follow from that, including business practice, policy and education. For this reason, implementing these principles will be transformational.”*

*(Meyer 2020)*

## Examples of Business Purpose



### **Our strategy**

*Our purpose is to make sustainable living commonplace.*

*It’s why we come to work. It’s why we’re in business. It’s how we inspire exceptional performance.*

*Sustainable growth*

*Back in 1883, Sunlight Soap was launched in the U.K. by our founder — it was pioneering, it was innovative, and it had a purpose: to popularize cleanliness and bring it within reach of ordinary people. That was sustainable living, even then. We now have more than 400 brands and we are still driven by purpose.*

*We want to do more good for our planet and our society, not just less harm. We want to act on the social and environmental issues facing the world and we want to enhance people’s lives with our products.*

*We’ve been pioneers, innovators and future-makers for over 120 years. We plan to continue doing that. And we plan to do it sustainably.*

*This is how we will grow our business.*



*The world is changing at a rapid pace. More and more urgently than ever, solutions are needed for a more sustainable future. Chemistry plays a key role here. In almost all areas of life, it can help overcome pressing global challenges with innovative products and technologies, from climate change and using resources more sparingly, to feeding the world's population. This belief is expressed in our corporate purpose and is what motivates us day in and day out: We create chemistry for a sustainable future.*



### **We are a sustainable company**

*We know that producing food impacts the planet. We aim to reduce our impact.*

*We're on a journey to become the most sustainable protein company, not just in Canada, but on earth.*

*We are carbon neutral.*

*We are one of the only food companies in Canada to set science-based targets.*

*We aim to reduce our environmental footprint by 50 per cent by 2025.*

### **Our commitments to you**

*Sustainability is something we do more than just talk about at Maple Leaf Foods. It's central to every aspect of our business, from the food we make, to the animals we care for, to the communities we live and work in, and the planet we must protect.*

*Our sustainability commitments guide all our decisions and help us build a better food industry. We have a plan.*

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Companies are also experiencing increasing calls for them to express and act consistently with a broader purpose. One notable example is from Larry Fink, CEO of Blackrock, the largest investment fund in the world. In his 2018 letter to the leaders of investee companies, he wrote:



*“Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.”*

*(Fink 2018)*

This expanded version of business purpose obviously builds on and extends the conversation about corporate sustainability. It is intuitively attractive (and strangely absent from earlier sustainability conversations) for companies to make their social and environmental aspirations clearer by committing to a purpose — a kind of touchstone for key decisions and actions. Even in a time of great uncertainty, purpose could potentially be a source of clarity and collective aspiration that could guide company directions, decisions and actions.

However, corporate purpose also faces a range of limitations common to many emerging business ideas.

First, while enthusiasts of purpose exhort businesses to express a purpose that transcends financial gain, there are relatively few practical examples and little guidance on how to generate, implement and enact such a purpose.

Second, there appears to be a sense among some commentators that purpose should be mandatory to all businesses. This would clearly be a major step and the implications (positive or negative) are not clear for companies whether public or private, across industries, operating regions and sizes. It’s also unclear who would drive such a change. Regulators? Investors? Consumer groups or customers? Civil society groups? Business associations? There are many possible options but few that would have a comprehensive reach to companies of all shapes and sizes across jurisdictions.

Third, there is relatively little evidence that business purpose contributes to companies’ success in financial, social or environmental terms (beyond a few early cases focusing on benefits to employees where such data is readily available). So, the rationale for companies to develop an aspirational purpose is not yet driven by broad experience and quantifiable measures.

Lastly, there are concerns that corporate purpose without verifiable action is meaningless. Like other forms of corporate sustainability and sustainable finance, corporate purpose sets lofty goals that are quickly met by skepticism from many sides, including from business leaders (for being unnecessary), civil society (for being insufficient or obfuscating real problems), consumers (for being confusing) and others. In a recent paper, strategy professor Sarah Kaplan states: “Despite many bold pronouncements by companies about pursuing purpose and not just profits, evidence suggests that these are often decoupled from real action on social and environmental issues.” (Kaplan 2022, forthcoming)



However, corporate sustainability and sustainable finance have had the time to mature, to help companies to make progress, and to collect stronger and stronger evidence of their utility. As newcomers, practitioners of corporate purpose will need to go beyond such bold pronouncements and make clear commitments to action and share their actual achievements (including their challenges and setbacks). Some of this might be built on top of the systems that have been created to report on sustainability and ESG performance, but it remains to be seen how companies should best make such commitments to action, and how they will be held accountable for them.

Nevertheless, as the idea of business purpose gains ground, there are a number of factors that might motivate leaders to move their companies towards business purpose: personal commitment; changing investor expectations (as in Fink's call above); evidence of improved financial performance by companies that are strong CSR performers (as a proxy for the potential of clearer purpose); or the growing requirements of social and environmental reporting.

This briefing will return to purpose after exploring the now immense universe of sustainable finance.

## 2. Finance: How financial and investment decisions relate to society or social issues

Another avalanche of concepts and terms relates specifically to sustainable finance. We use the term sustainable finance to describe all forms of investing and corporate finance that consider the risks associated with companies' non-financial behaviour and performance.

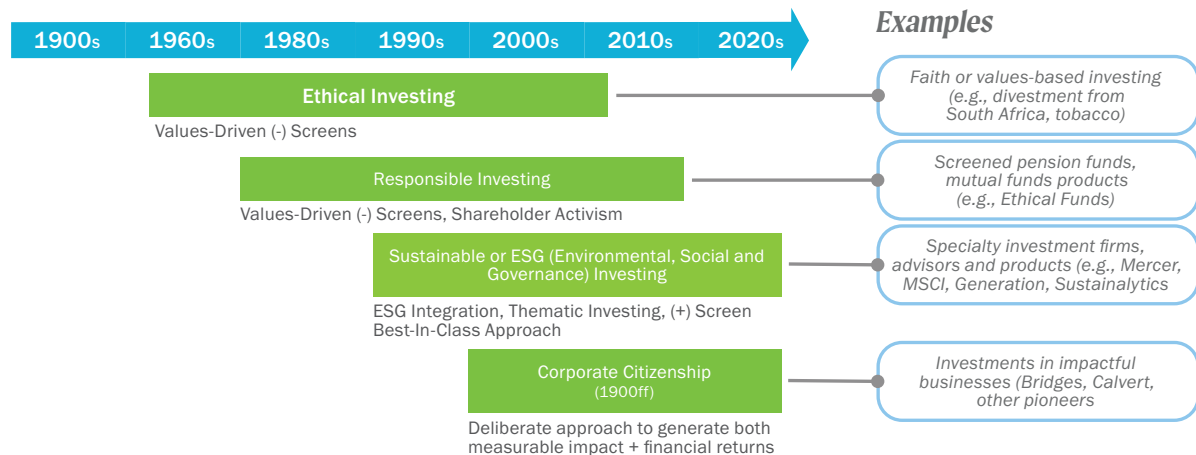
Like corporate sustainability, sustainable finance is not new. For centuries investing preferences and practices have sometimes been led by considerations relating to ethical preferences relating to specific social or environmental issues. For example, Quakers were leaders in the anti-slavery movement, choosing not to do business in slavery and, later, actively seeking to abolish slavery. At the same time, Quakers were among the most active participants in the whaling trade, something others have since objected to. In the 1980s, social advocates succeeded in shifting investment funds away from apartheid-era South Africa. Since that time, a whole range of investment opportunities has been developed for those who wish to avoid certain industries (such as tobacco or arms manufacturing) or prioritize others (such as green energy or funds dedicated to disadvantaged groups). As well, there are a number of services available to investment funds to help with their investment decisions by providing data about companies' environmental, social and governance (ESG) behaviour.

In brief, there are four major groupings of sustainable finance offerings for institutional and retail investors. These comprise investment strategies (approaches to matching the ethical or ESG objectives of investors) and investment products (to create easier-to-access mechanisms for investors to





make appropriate investment choices). The four groups are ethical investing, responsible investing, sustainable or ESG investing, and impact investing. They arose at approximately the times noted in the chart below.



Source: Adapted from Deutsche Bank, Sustainable Investing, Established Long-Term Value and Performance, 2012

## Sustainable Finance Terms

**Ethical investing** typically “screens out” investments that are considered to be objectionable by some investors. Examples include tobacco, gambling, guns, alcohol or for reasons of political beliefs. Early adopters of this approach were some religious orders’ pension funds and university endowments. These faith or values-based screens were generally applied informally among public equities (e.g., by avoiding specific stocks that did not meet the ethical test) because there were few actual ethical investment products prior to the rise of responsible investing in the late 1980s and 1990s.

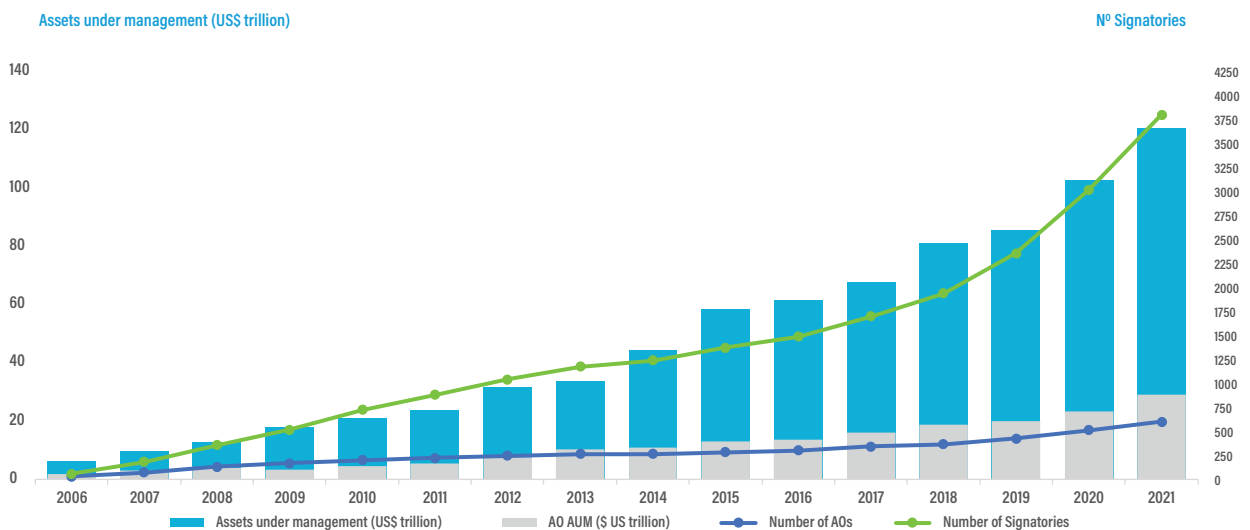
**Responsible investing** provided easier access to ethical investments by creating funds and products that screened out or emphasized particular companies or industries in public equities as well as other assets. For example, some mutual funds were created that removed “sin stocks” or focused on “green stocks.” These kinds of products are now increasingly available through exchange-traded funds (ETFs). There is also a vast array of green bonds available to institutional investors, sometimes offered to consumers via mutual funds or ETFs, and even money market funds that emphasize or exclude certain countries based on perceptions of their political behaviour. Responsible fund managers also tended to become more involved in corporate governance, intervening on key social or environmental issues through “active management.”



**Sustainable investing** (commonly called ESG investing) is an approach to investing in which an analyst considers environmental, social and corporate governance (ESG) data to understand a company's exposure to business risks that go beyond traditional financial analysis. ESG analysis assesses the company's relationships with key stakeholders, compliance with social and environmental regulation, and the adequacy of a company's governance processes. Strong positive ESG performance is often an indication of a well-managed company. Sustainable investing can also refer to an investing approach that seeks out "best-in-class" companies in an industry, even if that industry might otherwise be considered to have ESG risks (such as oil). Choosing the "best in class" means that an investor can participate in a company's growth even if it is in a controversial industry.

**Impact investments** are "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets and target a range of returns from below market to market rate, depending on investors' strategic goals. Impact investing is not an asset class but an approach to investing." (Global Impact Investment Network) In 2020, global impact investments assets under management had grown to \$715 billion (U.S.) and they continue to expand rapidly.

**As of 2021, \$121.3 trillion (U.S.) in assets of all types were under management using sustainable investment principles.**



Source: <https://www.unpri.org/about-us/about-the-pri>



In terms of global capital markets, at least 35.9 per cent of global assets are reported to be sustainable investments.

### Snapshot of global assets under management 2016-2018-2020 (USD billions)

REGIONS	2016	2018	2020
Total AUM of regions	81,948	91,828	98,416
Total sustainable investments only AUM	22,872	30,683	35,301
% Sustainable investments	27.9%	33.4%	35.9%
<b>Increase of % sustainable investments</b> (compared to prior period)		<b>5.5%</b>	<b>2.5%</b>

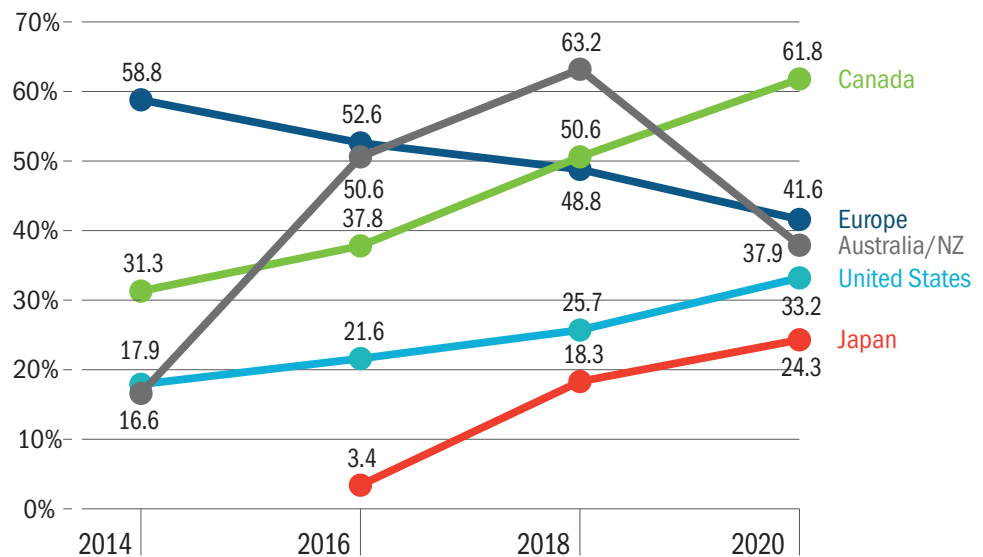


**35.9%** of total assets under management are sustainable investments

Source: <http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf>

This amount grew particularly quickly in Japan, which is late to reporting and so has likely reclassified a portion of previously unrecognized funds, and in Canada. Although an early market leader, Europe's numbers have fallen recently as their reporting regimes have become stricter, a phenomenon likely to be seen in the future elsewhere.

### Proportion of sustainable investing assets relative to total managed assets 2014-2020

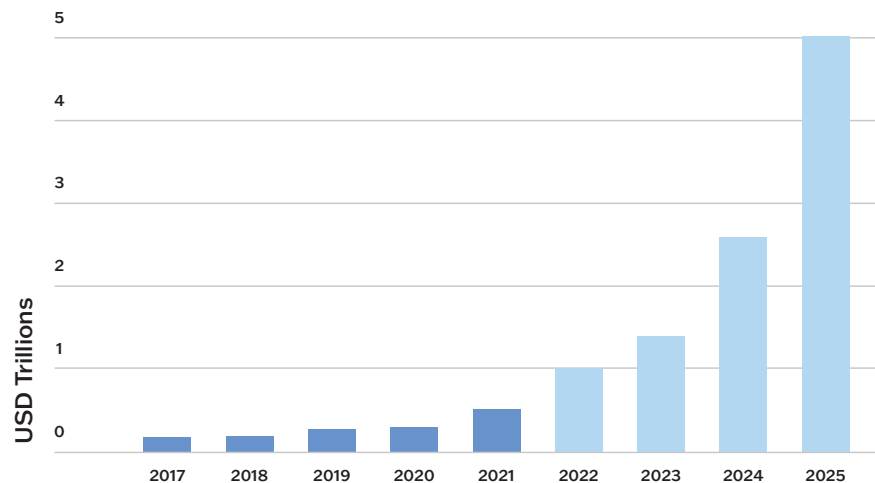


Source: GSI <http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf>

Beyond equities, bonds have also been developed for investors. Green bonds, issued by organizations looking to make major investments to improve their environmental performance, have also grown rapidly. The Climate Bonds Initiative shows they have grown to about \$1 trillion (U.S.) cumulatively in 2022, with projections suggesting continued growth.



### Green Bond Issuance (USD Trillion)



Source: Climate Bonds Initiative <https://www.climatebonds.net/2022/01/500bn-green-issuance-2021-social-and-sustainable-acceleration-annual-green-1tn-sight-market>

But just as CSR received strong criticism from some business leaders, sustainable finance has also found itself under fire at times. Many traditional market commentators, following the Friedman doctrine, remained unimpressed with responsible investing for decades. The common complaint is that sustainable finance threatened the fiduciary duty of fund managers because they would be reducing returns to shareholders (whether institutional or retail). Critics argued that fund managers would be forced to choose companies that would not necessarily be top performers across sectors (say, no oil companies) or that would be less likely to pursue high returns (because “responsible” companies were trying to meet social or environmental goals that would distract them from maximizing short-term returns), or because this choice would reduce diversification, thereby increasing risk.

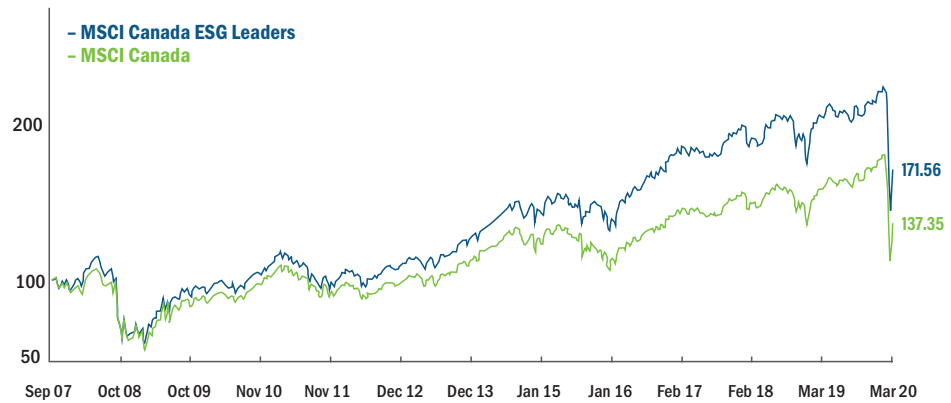
In some ways, these criticisms seems sensible, at least in the context of “shareholder capitalism.” However, interestingly, these arguments have not borne out in reality.

Companies chosen as part of many ESG-driven market indices have outperformed their underlying benchmarks over time. As an example, the MSCI Canada ESG Leaders Index (Canada) outperformed the MSCI Canada Index by 34 per cent between 2007 and 2020, even during the initial crash caused by the COVID-19 pandemic.



### MSCI Canada ESG Leaders Index (CAD)

CUMULATIVE INDEX PERFORMANCE – GROSS RETURNS (CAD)  
(SEP 2007 – MAR 2020)



Although this is an example of a single fund, multiple studies have shown similar results across markets and indices. A huge meta-study, “Sustainable Investing: Establishing Long-Term Value and Performance,” reviewed dozens of scholarly papers on the relationship between CSR, ESG and corporate financial performance (CFP). That study concludes:

*“There is overwhelming academic evidence, within all (100%) of the studies that we have found showing that firms with higher ratings for CSR and ESG factors have a lower (ex ante) cost of capital in terms of debt (loans and bonds) and equity. In effect they are lower risk in a fundamental (not necessarily short-term volatility) sense. In some ways this is the most impressive result as it firmly puts the issue of Sustainability into the office of the Chief Financial Officer.*

*There is compelling academic evidence that at the underlying security/market index level that strong CSR and ESG factors are correlated with CFP [corporate financial performance] outperformance, both market and accounting based. 100% of the studies we found show firms with high ratings for CSR exhibit outperformance, while 89% and 85% of the studies we found show firms with high ratings for ESG (or E, S, or G) exhibit market based or accounting-based outperformance, respectively.”*

*(DB Climate Change Advisors 2012)*

Recently there has been another backlash against ESG investing, notably by Mike Pence during his run-up to the next U.S. presidential election in 2024, and by Elon Musk due to Tesla’s delisting by the S&P ESG Index. Obviously, some of this criticism is politically and personally motivated, but it may reflect the fact that there is increasing traction in ESG investing and that it is more and more threatening to those who hold to the “shareholder capitalism” theory.



There's also a mismatch of domains that may not be obvious to those less familiar with sustainability terms. Simply put, ESG analysis is not synonymous with considerations of positive environmental or social impact.

To briefly reiterate, corporate sustainability is about strategy. It guides companies' choices about key social and environmental issues and key stakeholders. ESG analysis is an investment approach that seeks to identify and manage environmental, social and governance risks in potential investments to maximize investment returns. Rarely does ESG analysis point to market potential, which is more likely to be found through a more traditional sector or company market size/potential analysis. Impact analysis can be found in the highly specific subset of impact investing, where it assesses the potential for companies to create social or environmental value as part of their business models. The three approaches are related but different.

Those who protest that ESG analysis is a tool of leftist agitators are forgetting that the capital markets are now dominated by ESG approaches by fund managers seeking to reduce risks (and thereby maximize returns). Those who are concerned that ESG analysis doesn't highlight impact are confusing ESG analysis for impact analysis. However, as in the case of Tesla, if an otherwise sustainable or impactful company refuses to provide information about ESG risks, it will not be rewarded by the majority of current investors.

There is undoubtedly a good deal of overlap in these ideas, but technically they are different domains.

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### **Sidebar**

#### **Pence and Musk: ESG is a Threat to Capitalism**

Past U.S. vice-president Michael Pence recently raised concerns about a group of activist investors associated with Engine No. 1, an investment firm that uses an ESG investment approach. This group used the most recent ExxonMobil shareholder meeting to engage in a proxy battle to place three of their favoured candidates on Exxon's board. According to Pence, "Those three are now working to undermine the company from the inside" and are pursuing a "left-wing" agenda (Niquette and Crowley 2022).

Effectively, Pence is crying "don't tread on me" against active owners who advocate for better ESG performance. Like many other traditional capital market players, Pence apparently still believes shareholder primacy should prevail and



that ESG analysis is synonymous with anti-market politics. The implication is that ESG analysis destroys value when a good deal of evidence shows that the reverse is true. In fact, he should be lauding the fact that strong ESG performers tend to outperform those who do not. Why are he and his allies arguing against higher returns?

With respect to Tesla, Margaret Dorn, senior director of the S&P Dow Jones Indices, reported that it was dropped from the S&P ESG Index because its overall ESG score had declined relative to other auto companies due to “poor working conditions at its U.S. Fremont factory, claims of racial discrimination and its handling of a U.S. government probe into multiple deaths and injuries linked to its autopilot technology” (Kerber and Jessop 2022).

Tesla CEO Elon Musk’s response was a series of tweets including the statement “ESG is a scam. It has been weaponized by phony social justice warriors” (May 18, 2022).

Musk is facing the real challenge that ESG programs focus on mitigating risk to improve returns rather than celebrating positive social or environmental impact: “ ‘Ultimately ESG is a way of identifying and trying to quantify risk. So, it’s basically risk mitigation,’ said Chi Chan, portfolio manager at Federated Hermes” (Kerber and Jessop 2022). Musk is correct that Tesla is not being rewarded by ESG analysis for potential impact, but sadly that’s not what ESG analysis does. Instead, as noted above, ESG analysis seeks to identify and reduce investment risk by steering clear of exposure to environmental, social and governance problems. There’s no doubt that this may seem counter-intuitive to those with less familiarity with the terms, but it may yet prove to be an exploitable weakness in ESG.

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### 3. Reporting: terms related to reporting standards, systems and procedures

Reporting on sustainability or ESG performance – to investors, regulators, international standards bodies, ESG data providers, and various company ESG or sustainability ranking programs – is a daunting task. Some data needs to be part of the annual reporting process and so must be signed off by the chief financial officer. Some may include sensitive competitive information or expose challenges in the company. Some may be done at a local or divisional level using local standards but must be aggregated for a comprehensive global report.



This is the realm of technical, environmental and legal specialists. Without getting too far into the details, most public (and many private) companies are already expected to report on the following issues to a range of ESG data collectors, investment firms and regulators:

Environmental pillar				Social pillar				Governance pillar	
Climate change	Natural resources	Pollution & waste	Environment opportunity	Human capital	Product liability	Stakeholder opposition	Social opportunity	Corporate governance	Corporate behaviour
Carbon emissions	Water stress	Toxic emissions & waste	Opportunities in clean tech	Labour management	Product safety & quality	Controversial sourcing	Access to communication	Board diversity	Business ethics
Product carbon footprint	Biodiversity & land use	Packaging material & waste	Opportunities in green building	Health & safety	Chemical safety		Access to finance	Executive pay	Anti-competitive practices
Financing environmental impact	Raw material sourcing	Electronic waste	Opportunities in renewable energy	Human capital development	Financial product safety		Access to health care	Ownership	Corruption & instability
Climate change vulnerability				Supply chain labour standards	Privacy & data security		Opportunities in nutrition & health	Accounting	Financial system instability
					Responsible investment				Tax transparency
					Health & demo risk				

Source: PWC 2022

Most larger companies also issue an additional sustainability or ESG-specific report. A recent KPMG study stated that about 80 per cent of the top 100 companies by revenue provide a report on sustainability, up from 64 per cent since 2011. (KPMG Impact 2020)

The most important reporting standards can be divided into general standards (including classification systems like the UN's SDGs) and those that are more specific to environmental reporting (notably, about carbon):

### General

- PRI (Principles for Responsible Investment)
- UN Social Development Goals – not technically a reporting standard, but often used for reporting
- GRI (Global Reporting Initiative)





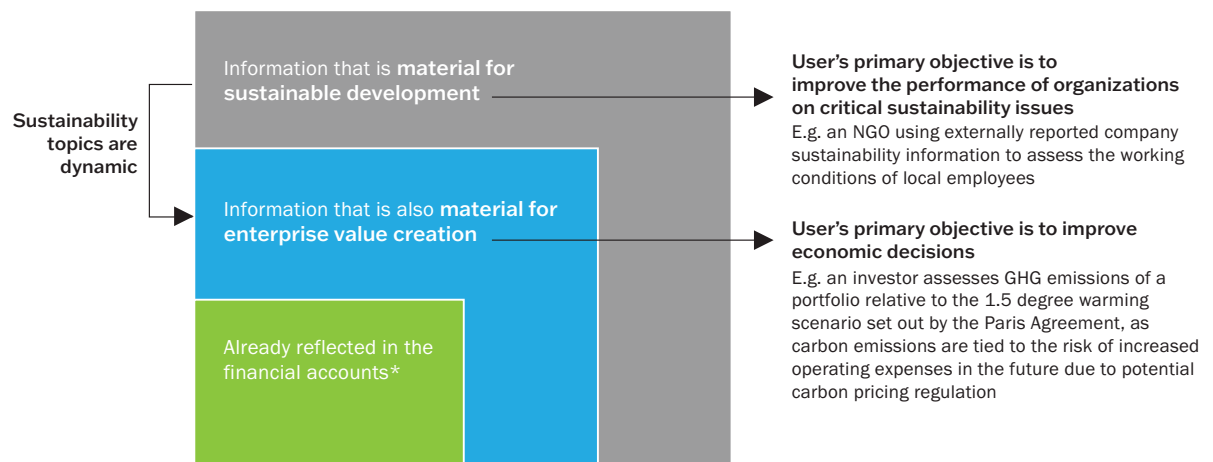
- SASB (Sustainability Accounting Standards Board) – note its materiality map
- IIRF (International Integrated Reporting Framework)
- ISSB (International Sustainability Standards Board) – new and in development
- ISO 26000 – voluntary standards guide

### Environmental

- TCFD (Task Force on Climate-related Financial Disclosures)
- CDP (Carbon Disclosure Project)
- GHG Protocol (Greenhouse Gas Protocol)

Key among these are the SASB standards, which provide a useful diagram for the kinds of disclosure expected, first by outlining disclosures that help a company manage risk or create economic value for itself, and second by describing disclosures that reflect how a company creates value for society:

### Scope of Sustainability Disclosure



\*including assumptions and cash flow projections

Source: SASB 2021



As an example of the comprehensive nature of these standards, here is a chart of how the issues intersect with specific industries even before getting into the details about a specific company.

		Consumer Goods	Extractives & Minerals Processing								Financials	Food & Beverage	Health care	Infra-structure
Dimension	General Issue Category		Coal Operations	Construction Materials	Iron & Steel Producers	Metals & Mining	Oil & Gas-Exporation & Production	Oil & Gas-Midstream	Oil & Gas-Refining & Marketing	Oil & Gas-Services				
Environment	GHG Emissions		█	█	█	█	█	█	█	█		█	█	█
	Air Quality			█	█	█	█	█	█	█		█	█	█
	Energy Management	█		█	█	█	█	█	█	█		█	█	█
	Water & Wastewater Management	█	█	█	█	█	█	█	█	█		█	█	█
	Waste & Hazardous Material Management	█	█	█	█	█	█	█	█	█		█	█	█
Social Capital	Ecological Impacts		█	█	█	█	█	█	█	█		█	█	█
	Human Rights & Community Relations		█			█	█	█	█	█		█	█	█
	Customer Privacy	█									█	█	█	█
	Data Security	█									█	█	█	█
	Access & Affordability										█	█	█	█
Human Capital	Product Quality & Safety	█									█	█	█	█
	Customer Welfare										█	█	█	█
	Selling Practices & Product Labelling										█	█	█	█
	Labour Practice	█	█			█	█	█	█	█		█	█	█
	Employee Health & Safety		█	█	█	█	█	█	█	█		█	█	█
Business Model & Innovation	Employee Engagement Diversity & Inclusion	█									█	█	█	█
	Product Design & Lifecycle Management	█	█	█			█	█	█	█	█	█	█	█
	Business Model Resilience		█	█			█	█	█	█		█	█	█
	Supply Chain Management	█	█	█	█							█	█	█
	Material Sourcing Efficiency	█										█	█	█
Leadership & Governance	Physical Impacts of Climate Change										█	█	█	█
	Business Ethics					█	█	█	█	█	█	█	█	█
	Competitive Behaviour		█	█			█	█	█	█	█	█	█	█
	Management of the Legal & Regulatory Environment						█	█	█	█				
	Critical Incident Risk Management						█	█	█	█				█
	Systemic Risk Management									█			█	█

Source: SASBY 2021

These standards are constantly evolving and there are several attempts to standardize them across jurisdictions (such as the IIRF, above). There are also many, many standards and systems for specific industries and contexts. Company leaders must ensure their teams are knowledgeable about these standards and their requirements.

Additionally, there is a constant growing expectation that corporate disclosures are transparent, verifiable or even audited. As an example, several professional accounting firms (such as KPMG), ESG research firms (such as Sustainalytics) and others (such as the Climate Bond Initiative) have established services to assure and certify the “greenness” of green bonds. Others are beginning to audit sustainability reports or the ESG data provided to investors. There is clearly growing demand, growing complexity and potentially growing risk for those who do not comply.



## Where to from here?

This briefing provided an overview of three different (but related) domains of sustainability: in strategy (corporate sustainability and purpose); finance (ESG analysis and other approaches to sustainable finance); and reporting (sustainability reporting standards). It covered how they developed and the most common (and most current) terms. The briefing also provided a sense of what's on the horizon — increasingly higher expectations and scrutiny. Understanding each of these domains, where they came from and where they are headed, is fundamental to help leaders make appropriate choices for the company.

First, *strategy*. This domain is about how company leaders understand and make choices about their interactions with social and environmental issues. What are the most important issues for a company and its stakeholders? What position will it take relative to those issues? How will it ensure that its decisions and actions are aligned with that position, because it's all too easy, especially in a large company or conglomerate operating globally, for some of its actions to be out of step with its commitments (whether expressed as a purpose or not).

The emerging concept of corporate purpose as a way to anchor strategy is promising but still in early days. There are a few good examples and some powerful advocates, but corporate purpose (like other approaches to corporate sustainability in their infancy) remains an untested idea with only modest evidence that it is helpful to companies in terms of improving their social, environmental and business performance.

Partially this is due to the lack of data. The earliest relevant studies use more readily available data (such as employee surveys) and are providing positive signals. It's something worth further investigation, which we and many others will be pursuing.

This means that there are a number of opportunities to build a stronger case for corporate purpose. Specifically, there is a need for:

- guidance on how to generate, implement and enact such a purpose and examples of what worked and what hasn't;
- clarity about which companies might best prioritize purpose (for example, public or private, priority industries, supporting jurisdictions and regulations and incentives, and best size of company);



- better evidence that business purpose contributes to companies' success in financial or social or environmental terms; and
- better guidance on how to act and report on progress in a way that is transparent and meaningful to key stakeholders.

In the next decade as this approach matures, it seems likely that expectations of better performance in corporate sustainability and greater experiences about corporate purpose will continue to build.

There is already compelling evidence that sustainability performance is related to stronger financial performance. However, this might be a causal relationship (a direct cause-and-effect relationship), or it could simply be correlated with the effect. That is, sustainability performance may largely be an indication of well-managed companies that can deal efficiently with complexity and the demands of multiple interests rather than an indication that “virtuous companies do better than others.” Either way, the effects are clear: sustainable companies reduce their cost of capital and tend to outperform competitors.

Therefore, it seems increasingly probable that strong sustainability performance, along with clear comprehensive reporting to verify this performance, will continue to be a growing expectation by major investors.

Critics of corporate sustainability and sustainable finance are becoming increasingly loud as these concepts threaten those who hold strictly to the shareholder capital model, or who wish for their intent to create social or environmental value to compensate for actual poor ESG performance or lack of transparency in their operations. At the same time, powerful advocates are getting more pointed in their view that attention to sustainability, sustainable finance and reporting brings value that will be rewarded – or that will punish those who do not meet their expectations.

In terms of reporting, expectations are also likely to continue to grow. However, there's increasing emphasis (and much work being done) to create simpler, co-ordinated reporting systems to standardize requirements across countries, industries and for a range of stakeholders. Like the evolution of accounting standards, this is likely to be a long and laborious process.

Ultimately, each company needs to be deliberate about its position relative to social and environmental issues to have a clear strategy. Companies will be expected to provide clear answers about their ESG performance whether they consider themselves to be sustainable companies, or even take the additional



step of making commitments to be purpose-driven. With respect to finance, companies must face the fact that capital market players are scanning for ESG risks to make choices about where to flow (or not flow) their investments. All this will be based on increasing calls for reporting transparency – the collection and sharing of complex data, often using multiple reporting standards simultaneously. Others, such as government and NGO observers, will also likely use company commitments and reports to monitor and publicly call out poor ESG behaviour or insufficient reporting, especially if any are inconsistent with a company’s stated purpose.

Corporate sustainability and sustainable finance are maturing approaches with a fair degree of evidence that they add value to companies and ultimately to society. ESG reporting standards and their use by investors are moving towards maturity and better co-ordination across the many systems that now exist, which will likely make them even more ubiquitous.

The emerging concept of corporate purpose (beyond economic success) is currently at an earlier stage of development, and its value to companies and society has yet to be tested and confirmed. The complexity of the data needed, and the breadth of issues, companies and measures involved, will take some time to collect and evaluate. Nevertheless, corporate purpose appears to hold significant promise to help companies clarify their roles in society, consider a broader set of stakeholders, make more relevant governance and strategic decisions, and better align their actions with their purpose. As with corporate sustainability and sustainable finance, the value of purpose will likely be determined quickly (perhaps in the next decade) and hopefully it will be proven to be as least as valuable as its immediate predecessors.

In this time of uncertainty, environmental, social and political strife, and the spectre of war, it is possible that early adopters of purposefulness will be rewarded for their clarity and commitment beyond economic prosperity. Company leaders who are intrigued by this approach should monitor new cases, new research and carefully consider their own paths. Among all the many concepts and terms covered in this briefing, purpose remains the most elusive – and potentially most powerful – of all.



## About the author

Rod Lohin helps business leaders create and capture value through distinctive sustainable strategies and finance. He leads a sustainability research centre and teaches at Canada's top business school. Formerly a management consultant, he built a successful practice at pioneering firm Manifest. He continues to consult with top local and global brands like RBC, SunLife and Blackberry.

Rod is a co-founder of OpenImpact (an open-source inventory of impact investment products in Canada) and a founding member and Treasurer of Rise Asset Development (a micro-finance organization helping people with mental health and addictions explore entrepreneurship).



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