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Towards a New Paradigm of Company Valuation

A Literature Review of Emerging Frameworks for
Long-term Social and Environmental Sustainability



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Introduction to the Project

Towards a New Paradigm of Company Valuation: A Literature Review of Emerging Frameworks for Long-term Social and Environmental Sustainability is being developed by the Oxford Analytica Foundation on behalf of the Caux Round Table for Moral Capitalism. An initial consultation draft was issued in July 2018, and this October 2018 version builds on relevant comments. After a further consultation period is completed, a final project report will be issued.

Part One sets forth a *Review of Academic Literature on the Changing Scope of Company Valuation Methodologies*. Part Two sets forth a *Review of Thought Leadership on Sustainable Value Creation and Measurement*. This review charts both traditional valuation methodologies as well as emerging frameworks. It also highlights the work of various multi-sector initiatives. Overall, it underscores how company valuation is broadening to include new understandings of capital and intangible assets. The final report will include an introductory section featuring the following key themes:

- The commitment of the Caux Round Table to advancing both business values and new methodologies for business valuation. Its research and advocacy activities emphasize the need to look beyond short-term financial results to the various “capitals” that contribute to both business and societal success. A useful framing of these issues is presented by Stephen B. Young, Global Executive Director of the Caux Round Table, in an article entitled: “Tipping Global Capitalism towards Sustainability” (*Pegasus* newsletter of September 2017, available at: <http://www.cauxroundtable.org/index.cfm?&menuid=139>).
- A description of the *Corporate Stewardship Compass* developed by the Oxford Analytica Foundation on behalf of the Caux Round Table in 2017. Its findings are relevant to this follow-up project in several ways, including the policy context of the UN Sustainable Development Goals (SDGs), the ethical context of corporate responsibility, the influence of environmental, social and governance (ESG) factors, and the relationship between corporate stewardship values and valuation. The full report can be found at: <https://www.oxan.com/media/2173/caux-round-table-corporate-stewardship-compass-final-report.pdf>
- An indication of the growing need to enhance valuation methodologies to include non-financial factors, especially given the changing dynamics between business and society. One such example is cited in the *Corporate Stewardship Compass* report. In 2017, research analysts for the Dow Jones Sustainability Index made the following observation regarding the difficulties companies face in finding a viable valuation approach:

In light of the Sustainable Development Goals (SDGs)... companies, governments and investors alike want to understand both the positive and negative externalities inherent in companies’ business models and how their products, services and operations contribute to, or detract from, the achievement of the SDGs. Analysis of the CSA data set shows that while the vast majority (70%) of companies are aware of the need to understand these types of environmental and social profits and losses, less than 10% of companies actually have a viable valuation approach in place today that provides detailed insights into these potential financial impacts.

- A brief introduction to Part One of the document: *Review of Academic Literature on the Changing Scope of Company Valuation Methodologies*. This concise annotated bibliography is divided into two categories. The first presents leading books and articles about traditional valuation

methodologies from both an academic and practitioner’s perspective, addressing private and public companies. The second presents leading books and articles on emerging metrics for valuation, focusing on human capital, natural capital, reputational capital, social capital and sustainable valuation.

- A brief introduction to Part Two of the document: *Review of Thought Leadership on Sustainable Value Creation and Measurement*. This features descriptions and web-links for high-level collaborations such as the Embankment Project for Inclusive Capitalism, the Sustainable Stock Exchanges initiative, the Social and Human Capital Coalition, and the British Academy’s Future of the Corporation Program. These resources, drawing on expertise from various sectors, serve as a useful complement to the academic-style literature review. Moreover, they often focus on potential reforms in business practices and public policies.
- Finally, while this consultation draft offers some closing observations, the final version of this report will have a concluding section with insights on the international momentum surrounding questions of valuation, advances in the measurement of social and environmental impact, relevant policy developments, and prospects for further engagement. This project hopes to contribute to the evolution of a new paradigm of company valuation for long-term sustainability.

Questions or comments about this consultation document on company valuation may be directed to: Catherine Young at cyoung@oxford-analytica.com; www.oxan.com/foundation/

Part One: Review of Academic Literature on the Changing Scope of Company Valuation Methodologies

This annotated bibliography on company valuation provides a concise series of entries that reflects both academic research and practical guidance. Drawn from books and articles published over a period of years, it serves to signpost the current state of the discipline as well as emerging frameworks. It shows how the scope of valuation methodologies are broadening to include social and environmental issues and other intangible assets.

Concepts such as discounted cash flows, price-to-earnings ratios, asset valuations, and public company comparables help business leaders navigate the valuation landscape with a fair amount of accuracy. Social capital, human capital, natural capital, and reputational capital can influence company appraisals. However, for the most part, unless a business is beset by an environmental disaster or similar reputational catastrophe, these four types of capital are rarely used to conduct valuations.

Traditional valuation methodologies are starting to address such anomalies. As of yet, there is no clear new paradigm. There seems to be a sense that social, human, natural, and reputational capitals should play a greater role in the valuation process. Business scholars such as Michael Porter have started building the foundation for a new paradigm. His concept of shared value begins to address the wider issues inherent in, for example, accurately accounting for the effect of environmental degradation. But in the absence of fully developed theories and mathematical models that encompass a progressive approach, company valuations continue to be conducted largely along customary lines.

As noted in the Introduction, this annotated bibliography is divided into two sections. Indeed, such a structure confirms the gulf between mainstream valuation practices and the more progressive ideas that seek to re-shape their formulations. The first section describes publications on traditional valuation methodologies from academic and practitioner-focused perspectives, addressing both private and public companies. The second section describes publications on emerging metrics for valuation, focusing on social capital, human capital, natural capital, reputational capital and sustainable valuation. Under each subsection, entries for books are presented first, followed by relevant articles or reports.

Many of the concepts mentioned within the annotated bibliography also feature in Part Two of this document, as they shape current thought leadership on sustainable value creation and measurement.

I. Books and Articles about Traditional Categories of Valuation

A. Academic Literature about Traditional Valuation

1. Private Companies

Damodaran, A. (2018), *The Dark Side of Valuation: Valuing Young, Distressed and Complex Businesses*, 3rd edition. Upper Saddle River, NJ: Pearson FT Press.

This book is referred to as the definitive guide to valuing hard-to-value companies. Valuing firms that are established and profitable is easy, observes Professor Damodaran. It is the difficult-to-value companies that cause problems for those who do appraisal work. Concepts and measurement tools often fail to meet expectations when trying to determine the value of start-ups, financial institutions, distressed companies, entities facing strong regulation, commodity firms, emerging market enterprises, and other types of businesses. The book helps the reader understand the peculiarities of valuing such firms. Damodaran examines companies across their life cycles. He also assesses distinctive situations, such as when: negative risk-free rates are involved; risk premiums are changing; young companies are disrupting legacy businesses; commodity or cyclical businesses experience price fluctuations; a company must be valued as the sum of its parts or as an aggregation of its users, subscribers and customers.

Petersen, C., Plenborg, T. and Schøler, F. (2006), "Issues in Valuation of Privately Held Firms," *The Journal of Private Equity*, Vol. 10 (1), pp. 33-48.

This article offers a highly readable and understandable exposition on valuation. The introduction provides an overview of the field, covering topics such as: discounted cash flow analysis, economic value added (EVA), valuation for retirement plan investments in equity, and the ways that valuation are used by larger strategic acquirers as well as private equity firms. The authors also analyze reasons for sale of private companies – especially the generational turnover of firms as founders retire. Equations for WACC – Weighted Average Cost of Capital – are explained. The article presents some analysis regarding the frequency with which companies are being offered for sale, as well as of company valuation in the context of litigation. The focal point is a study of one country's valuation practice – that of Denmark. The authors note that 44 institutions participated in their survey, including a state-backed investment company and various corporate investment advisors, banks, and private equity firms. In total, more than 60 sets of responses were collected. Key findings were that Capital Asset Pricing Models were used by all, as were liquidity discounts and present value models. There was less consistency in the use of long forecasting horizons, *i.e.*, of more than five years.

2. Public Companies

Barker, R. (2001), *Determining Value: Valuation Models and Financial Statements*. Upper Saddle River, NJ: Financial Times/Prentice Hall.

This book describes the various methods used to value public companies. Examples of valuation processes covered in detail include price-to-earnings ratio, dividend yield, and economic value added (EVA). An emphasis is placed on the importance of both the availability and the quality of data. Professor Barker is very clear about balancing the theoretical validity of a model with the realistic ability of a valuator being able to receive or discover required information. The book also identifies the relationship between various valuation models and clarifies assumptions made by each model. Case studies are offered, ensuring that valuation may be taught in a way that is accessible and meaningful. Professor Barker draws on his experience in teaching accounting and valuation at both the Judge Business School at the University of Cambridge, and more recently at the Saïd Business School at the University of Oxford.

Brealey, R.A. and Myers, S.C. (2010), *Principles of Corporate Finance*, 11th edition. New York, NY: McGraw Hill.

This is the most well-known book about corporate finance. Finance is the academic field under which, technically, the subject of valuation would fall. Since 1980, students and academicians have been turning to Brealey and Myers for guidance on myriad questions. With respect to corporate appraisal, the authors rely upon capitalization rates, dividend growth, price to earnings ratios, dividend yield, discounted cash flow, and earnings per share. The authors are known to be especially interested in what earnings mean. They help readers understand the difference between income and cash flow. Similarly, they offer warnings about what they call constant-growth formulas. These are rules-of-thumb that help users gain an understanding of value. But, as with many different fields that look to such momentum, a caution is raised that growth can almost never be sustained indefinitely.

B. Practitioner-focused Publications from a Traditional Valuation Perspective

1. Private Companies

Gladstone, D. and Gladstone, L. (2003), *Venture Capital Investing: The Complete Handbook for Investing in Small Private Businesses for Outstanding Profits*. Upper Saddle River, NJ: Financial Times/Prentice Hall.

David Gladstone has long-standing involvement with the U.S. venture capital industry. His bestselling book from the 1980s, *The Venture Capital Handbook*, is regarded as a classic in the field. He later collaborated with his daughter, Laura Gladstone, to prepare revised and updated versions. The topics covered include: analysis of financial projections, cash flow and balance sheets; fixed assets; liquidity ratios; risk reduction; using probability, present value, internal rate of return, net present value, and collateral; as well as the value of representations and warranties. Gladstone has served as the CEO and/or Chairman of Allied Capital, American Capital and Gladstone Capital – all publicly traded business-development finance companies. He has funded hundreds of companies and assessed thousands of others from the perspective of long-term value. Over the years, this publication has proven to be both accessible and useful.

Pratt, S. (2008), *Valuing a Business: The Analysis and Appraisal of Closely Held Companies*, 5th edition. New York, NY: McGraw-Hill.

This publication is known as the handbook for private company valuation, and Shannon Pratt is regarded as the leader in this field. This book encapsulates the main methods of valuing businesses that are not traded on public markets. It emphasizes discounted cash flow analysis, comparisons to public companies, and asset-based evaluations. In most cases, the discounted cash flow and public comparison methods will be most useful. Although in distressed sales, where there are no profits and few public company comparisons, the asset-based analysis may be a better guide. The book explains how company shares receive premiums or discounts in certain situations. Furthermore, it helps readers understand issues involving tax, data collection, credentials of valuation specialists, and how to conduct interviews of executives of companies that are being valued. Pratt's book is seen as a one-stop-shop for experienced practitioners as well as those who are new to private-company valuation.

Matthews, C. (1 July 2003), "More to It Than Numbers," *Inc. Magazine*. Retrieved from: <https://www.inc.com/articles/2003/07/pricetosell.html>

This brief article cites some of the top experts in the US valuation community. Matthews approaches appraisal from a small-company perspective, and thus her analysis is more relevant to someone selling a restaurant than a manufacturing company. There are various ways to determine a value, and the process is industry-specific in many situations. The piece relies on common sense approaches to understanding valuation – how long it takes for a professional to prepare a valuation, how much it should cost, how to choose a good valuator, and how to understand the basic thumbnail estimates that are often used in the valuation process.

2. Public Companies

Graham, B. (1949), *The Intelligent Investor*. New York, NY: Harper & Brothers.

Aficionados consider this to be one of the most important books ever written on the topic of investing and company valuation. The publication offers many quotes from Benjamin Graham, meant to motivate as well as educate investors about the strategies that can be used to make money and reduce risk. Graham focuses on concepts related to value-investing in publicly traded companies. He explains assets and profits, as well as technical trading. According to his philosophy of investing, it is best to buy stocks at a discount to their intrinsic value. By buying stocks that trade at a discount at the time of purchase, the investor does not depend on accurately predicting what a company's prospects might be. A key point is to focus on the particular attributes of the company being valued rather than on conditions in the market. This book has developed a cult-like following. While it was updated in the 1970's, many readers feel that its advice is timeless. Warren Buffett is a devotee, which helps to explain part of Graham's continued popularity.

Fernandez, P. (2002, revised 2007), "Company Valuation Methods: The Most Common Errors in Valuations," University of Navarra, IESE Business School Working Paper No. 449.

This working paper provides a comprehensive short overview of corporate valuation, especially relevant to larger companies. The discussion of stock market bubbles, for example, also offers insights for understanding large private entities. There are sections on valuing internet companies and on identifying common errors in valuations. Much of the paper is dedicated to a series of useful charts and paragraphs that compare the different valuation methods, including trends in value over time. In one case, a comparison is made between various conclusions of value that might be reached for one firm. This shows, for example, the disparity between valuations based on assets and those that are based on cash flows. While some formulas are presented, this accessible paper is suitable for readers without a high degree of familiarity with valuation.

II. Books and Articles about Emerging Metrics for Valuation

A. Social Capital

Grootaert, C. and van Bastelaer, T. (2001), "Understanding and Measuring Social Capital: A Synthesis of Findings and Recommendations from the Social Capital Initiative," World Bank Social Capital Initiative Working Paper No. 24. Retrieved from: <http://siteresources.worldbank.org/INTSOCIALCAPITAL/Resources/Social-Capital-Initiative-Working-Paper-Series/SCI-WPS-24.pdf>

While somewhat dated, this working paper summarizes a significant World Bank research project on social capital that is comprised of 23 other papers. It places the concept of social capital in a broad context and provides extensive bibliographies. How can the concept of social capital help describe what happens when individuals participate in relationships and communities? The paper addresses networks, economic development, poverty, ethnicity, as well as a variety of industries, regions, and institutions. Among the industries mentioned are waste management, mining, agriculture, trading and water supply. Regions include those that are urban, suburban and rural. Institutions are identified as political, informal, civic associations, NGOs, and regimes. Some of the measurement variables include: capital formation, trust, social cohesion, education, income, health, and levels of violence. These variables are placed within a set of models that focus on race, gender and policy. Attention is also given to governance and rule of law. While providing a valuable analysis of the subject, the working paper does not address the implications or measurement of social capital as it relates to business valuation.

Lins, K.V., Servaes, H. and Tamayo, A. (2017), "Social Capital, Trust, and Firm Performance: The Value of Corporate Social Responsibility during the Financial Crisis," *The Journal of Finance*, Vol. 72 (4), pp. 1785-1824.

During the 2008-2009 financial crisis, companies with high social capital, measured as corporate social responsibility (CSR) intensity, had stock market returns that were four to seven percentage points higher than firms with low social capital. High-CSR firms also experienced greater profitability, growth, and sales per employee relative to low-CSR firms. They were also able to raise more debt, which indicates that financial markets and investors had greater confidence in them. This evidence suggests that the trust between the company and both its stakeholders and investors, built through a focus on social capital, may pay off when the broader level of trust in corporations and markets suffers a negative shock – such as a financial crisis.

B. Human Capital

Sullivan, P.H. (2000). *Value-Driven Intellectual Capital*. Hoboken, NJ: Wiley & Sons Publishing.

One of the key questions this book answers is: How can buyers and sellers calculate the intellectual property assets of the acquired firm in a merger or acquisition? The author explains that since it is managerial talent that converts intellectual property into business assets, there

should be methods and processes for using intellectual property as an active element of a firm's business strategy. The book discusses how value is extracted from human capital. It also focuses on identifying and valuing a firm's intellectual assets: recipes, formulae, trade secrets, inventions, programs, and processes. There is a description of intangible assets -- what they are and how to convert them into cash. In contrast to the article by Professor Butt in the following entry, Sullivan makes no effort to determine the monetary value of employees. There is an assumption that intellectual property can be separated from many of the employees of a firm.

Butt, S.A. (2013), "How to Bring Human Resource Asset into Balance Sheet without Disturbing Any Financial Accounting Standards," *La Pensée*, Vol. 75 (12). Retrieved from: https://www.researchgate.net/publication/260132543_HOW_TO_BRING_HUMAN_RESOURCE_ASSET_INTO_BALANCE_SHEET_without_disturbing_any_financial_accounting_standards

While most companies acknowledge the value of their employees, at the time this article was written, no firm had tried to show this value on its balance sheet. Professor Butt explains this is due to three main problems: a) the absence of an accepted metric to use to measure the value of this asset; b) the apparent violation of generally accepted accounting standards; and c) the possible tax liabilities that could accrue as a result of valuing this asset. The article suggests solutions to all these problems. It is proposed that the financial value of what the author calls Human Resource Asset should be equal to the excess of NPV (net present value) of a firm with existing employees over NPV of the same firm computed on the assumption of having an average quality staff. Using this metric, human resources can be measured through a formal accounting process, debiting the Human Resource Asset (to be shown in the balance sheet as an intangible asset) and crediting a Human Resource Reserve (to be shown in the balance sheet as a non-distributable part of equity). The author also proposes periodic adjustments to this method, recognizing that there will be substantial resistance to what he is proposing.

C. Natural Capital

Chartered Institute of Management Accountants (2014), "Accounting for Natural Capital: The Elephant in the Boardroom." (Rapacioli, S., Lang, S. Osborn, J. and Gould, S., authors) Retrieved from: [http://www.ey.com/Publication/vwLUAssets/Accounting-for-natural-capital/\\$File/EY-Accounting-for-natural-capital.pdf](http://www.ey.com/Publication/vwLUAssets/Accounting-for-natural-capital/$File/EY-Accounting-for-natural-capital.pdf)

This report was published by the Chartered Institute of Management Accountants (CIMA), in collaboration with Ernst & Young LLP (EY), the International Federation of Accountants (IFAC), and the Natural Capital Coalition. It encapsulated the state of the art in accounting for natural capital in 2014, deriving credibility from the expertise of these respective organizations. The report does not offer specific advice on how accounting practices might change to reflect broad natural capital themes. Rather, it relies on established concepts such as material off-balance sheet liabilities to reflect decreased shareholder value. It recommends that problematic environmental issues be valued when they are discovered or announced by a corporation. This resembles the disclosures found in annual reports, which document the potential effect of law suits filed against a company. Unilever is noted by way of example; in 2013 it announced that the impact of climate change was costing the company €300 million a year as a result of drought and flooding. The usefulness of this type of corporate reporting is considerable. However, the report does not address prospects for

a new methodology -- consistent with accepted accounting principles -- that shows just how questions of natural capital should influence company share price.

Danish Environmental Protection Agency (2014), "Assessment of Potentials and Limitations in Valuation of Externalities, With Special Focus on Environmental Profit and Loss," Environmental Project No. 1561. (Glensvig, D.; Sørensen, M. M., Frier, C., Enggaard, M., Pedersen, J.K. and Mohammed, M., eds.) Retrieved from:
<https://www2.mst.dk/Udgiv/publications/2014/03/978-87-93178-33-5.pdf>

The Danish Ministry of the Environment sponsored this report, bringing together specialists from the consulting, green investing, development bank and academic communities. It highlights the components, strengths and weaknesses of Environmental Profit and Loss Statements (EP&L). Mindful of reporting costs, the authors do not recommend that such statements be prepared on an annual basis. Nor do they draw a clear connection between the market value of a company and the EP&L. Rather, using a data-driven and analytical approach, the paper explains how to create an EP&L which is separate from the valuation process a firm, valuator or potential investor might use to appraise a company. Two case studies of companies that have used EP&Ls effectively are presented: PUMA and Novo Nordisk.

Dowell, G., Hart S. and Yeung, B. (2000), "Do Corporate Global Environmental Standards Create or Destroy Market Value?" *Management Science*, Vol. 46 (8), pp. 1059-1074.

The authors analyze the global environmental standards of a sample of US-based multinational enterprises in relation to their stock market performance. They find that firms adopting a single, stringent global environmental standard have much higher market values than firms using less stringent standards. Accordingly, developing countries that use lax environmental regulations to attract foreign direct investment may end up attracting poorer quality, and perhaps, less competitive firms. For example, by specifying a single corporate standard, a firm's performance monitoring and evaluation costs might be reduced. A single set of values, specifications, and procedures can be deployed throughout the world, without the need to consider local deviations. Through this process, firms can actually use the environment as a strategic competitive advantage by speeding up the process of committing to standards that exceed those of host countries. Companies that use enhanced environmental standards might also benefit from heightened employee morale and thus productivity.

Smith School of Enterprise and Environment, University of Oxford (2013), "Stranded Assets and the Fossil Fuel Divestment Campaign: What Does Divestment Mean for the Valuation of Fossil Fuel Assets?" (Ansar, A., Caldecott, B.L. and Tilbury, J., authors) Retrieved from:
<http://www.smithschool.ox.ac.uk/publications/reports/SAP-divestment-report-final.pdf>

This paper is about divestment, which is widely understood. But it also about stranded assets – those that have suffered from unanticipated or premature write-downs, devaluations or conversion to liabilities. Here, the stranded assets under consideration are caused by divestiture campaigns initiated due to environment-related risks associated with fossil fuels. Stranded assets are also defined as those that have become obsolete or non-performing but must be recorded on the balance sheet as a loss of profit. The goal of a fossil fuel divestiture campaign is to lower the

value of assets owned by a company, and through this process lower the value of a company. The paper reviews discount rates, probabilities of outcomes and effects on cash flow. It concludes with three helpful sets of recommendations aimed at investors, fossil fuel companies and campaigners.

D. Reputational Capital

Klewes, J. and Wreschniok, R., eds. (2010), *Reputation Capital: Building and Maintaining Trust in the 21st Century*. Berlin, Germany: Springer-Verlag Berlin Heidelberg.

Klewes and Wreschniok have edited a long and valuable book that documents the importance of reputations. Rather than developing a methodology for valuing reputation, the authors of each chapter contribute case studies, descriptions and models of how organizations build good reputations and, in some cases, destroy value as reputations diminish. A problematic aspect of the reputation literature is the reliance upon changes in stock market prices to gauge the impact of corporate involvement in crimes, environmental disasters or other type of reputation-damaging events. Like many books that consist of an edited collection of chapters, it represents a range of specialist expertise. However, it tends to lack a unifying logic and would have benefited from a concluding chapter to bring the various streams together.

Hsu, F.J., Wang, T. Y. and Chen, M.Y. (2013), "The Impact of Brand Value on Financial Performance," *Advances in Management and Applied Economics*, Vol 3 (6), pp. 129-141.

This article examines the relationship between companies' brand value and their stock performance. It looks to the historical stock performance of global brands to see whether strong brands outperform a broad basket of equities. A company is considered a high-value brand if it is included in the annually published "Interbrand Global Top 100 Brands" ranking list. The researchers investigate whether the numeric brand values assigned by Interbrand have an effect on the brand portfolio return, including possible short-term announcement effects around the time of the survey's publication as well as longer-term returns. The findings indicate that the brand portfolio outperforms the S&P Index in various holding periods. The brand portfolio also creates a significantly positive risk-adjusted alpha. These results are in line with other research; evidence shows that the market's reaction to a firm's presence on the top brand lists is correlated with abnormally high returns.

Park, C.W., MacInnis, D.J., Drèze, X. and Lee, J. (2010), "Measuring Brand Equity: The Marketing Surplus and Efficiency (MARKSURE) Based Brand Equity Measure," *Brands and Brand Management: Contemporary Research Perspectives*, Psychology Press, Vol. 8, pp. 159-188.

This study proposes an alternative measure of brand equity, termed MARKSURE, that overcomes limitations of existing measures of brand equity. It examines use of the metric to assess a firm's brand equity and to evaluate the marketing activities of its brand. The authors discuss operational issues regarding this alternative measure, including the treatment of marketing costs. They also describe the limitations and boundary conditions of this alternative brand valuation system. The equity associated with brands has been identified as one of the most powerful intangible assets

deriving corporate value (others include investments in R & D, patents, databases, human capital, and software development.) Of considerable relevance is how brand equity should be defined and measured. This issue is indeed critical. A valid measure of brand equity could enable an assessment of a firm's brand on its balance sheet, particularly if it were theoretically-based and consistent with accounting standards. However, the development and application of such a measure is stymied by what some academics regard as the problematic treatment of intangible assets like brands in accounting practice.

E. Sustainable Valuation

Haskel, J. and Westlake, S. (2017), *Capitalism without Capital*. Princeton, NJ: Princeton University Press.

A comprehensive account of the growing dominance of the intangible economy, this book focuses on sunk costs, scalability, synergies, new infrastructure, management and leadership. Also addressed are so-called "spillovers" -- ideas which can easily be appropriated by competitors. They authors track the development of the intangible economy to the early twenty-first century when a quiet revolution occurred. For the first time, the major economies began to develop more intangible assets through design, branding, R&D, or software. There was less focus on tangible assets, like machinery, buildings, and computers. For all types of businesses, from tech firms and pharmaceutical companies to sandwich shops and accountancies, the ability to deploy assets that one can neither see nor touch is increasingly the main source of long-term success. *Capitalism without Capital* shows that the growing importance of intangible assets has also played a role in some of the big economic changes of the last decade. Moreover, it claims that the development of intangible investment is an underappreciated cause of problems such as economic inequality and stagnating productivity.

Böhringer, C. and Jochem, P.E. (2007), "Measuring the Immeasurable -- A Survey of Sustainability Indices," *Ecological Economics*, Vol. 63 (1), pp. 1-8.

Sustainability indices for countries provide a metric to evaluate country-specific information on the three dimensions of sustainable development: economic, environmental, and social conditions. At the policy level, the authors suggest that these are often treated as unambiguous yardsticks against which a country's development can be measured and even cross-country comparisons can be made. This article reviews the explanatory power of various sustainability indices applied in policy practice. The authors show that these indices fail to fulfill fundamental scientific requirements, making them rather useless if not misleading with respect to policy advice. The work of other academics has supported these conclusions. Thus, from such research about sustainability indices, lessons may be drawn regarding challenges in the analysis and valuation of company's sustainability performance.

Murad A., Pantzalis, C. and Park. J.C. (2010), "CEO Decision Horizon and Firm Performance: An Empirical Investigation," *The Journal of Corporate Finance*, Vol. 16 (3), pp. 288-301.

The authors investigate the effect of the myopia of top managers on a firm's market valuation. They devise a measure of expected CEO tenure as a proxy for the length of CEO decision horizon. After accounting for the endogenous nature of CEO horizon, their empirical tests show that shorter CEO horizon is associated with more agency costs, lower firm valuation and higher levels of information risk. The results are consistent with the notion that a short CEO decision horizon is indicative of preference for investments that offer relatively faster paybacks at the expense of long-term value creation. The research uses robustness tests to reach its conclusions.

Smith School of Enterprise and Environment, University of Oxford (2014), "Financial Dynamics of the Environment: Risks, Impacts, and Barriers to Resilience," Working Paper for the UNEP Inquiry into the Design of a Sustainable Finance System. (Caldecott, B. and McDaniels, J., authors). Retrieved from: <http://www.smithschool.ox.ac.uk/research/sustainable-finance/publications/UNEP-SSEE-Working-Paper-Financial-Dynamics-of-the-Environment.pdf>

This Working Paper, commissioned by the UN Environment Programme Inquiry into the Design of a Sustainable Finance System, aims to be a useful initial reference guide that:

- summarizes the underlying logic for why the financial sector should care about the state of the environment and environment-related risks;
- reviews the main structural barriers that could prevent the financial system from managing such issues;
- identifies the main researchers and organizations undertaking work on these topics internationally.
- The paper covers a variety of issues related to sustainability, carbon risk, stranded assets, natural capital, conservation, natural infrastructure, ecosystem resilience and natural disasters. Attention is given to ESG (Environmental, Social and Governance) reporting, as well as to the capacity of global financial governance regimes to identify and address risks. While the paper takes a broad geopolitical perspective, its insights are relevant to the context of corporate valuation.

Part Two: Review of Thought Leadership on Sustainable Value Creation and Measurement

The landscape of company valuation is changing rapidly. A review of academic literature would not be complete without consideration of the remarkable developments in thought leadership. Across diverse constituencies, innovative platforms and coalitions are seeking to clarify questions of sustainable value creation and measurement. These include standard-setting agencies, civil society organizations, research institutes, professional firms, public and privately held companies, and a wide range of actors in the financial sector. Many of these coalitions also engage with global economic governance organizations and local government regulators. With a practical focus, such efforts will deepen the discourse -- and mobilize action -- towards a new paradigm of company valuation for long-term sustainability.

1. B Lab

B Lab is a non-profit organization that serves a global movement to promote business as a force for good; www.bcorporation.net. A key initiative is the designation of Certified B Corporations. This assessment process recognizes companies that meet the highest standards of verified social and environmental performance, public transparency, and legal accountability. B Lab also publishes a quarterly called "B Magazine." Recent updates draw attention to the presence of B Corporations on the *Inc.* magazine list of 5,000 of the fastest growing privately-held companies in the USA; <http://www.bcorporation.net/blog/good-growth-26-b-corps-on-the-inc-5000-list>. In addition, under the banner of "Plan B," ten specific themes for action are identified. Among them is to "scale true accounting." In partnership with organizations in the finance sector, the B Lab will help to pilot, scale and standardize new metrics that enhance the flow of capital toward businesses driving positive environmental impacts and restoring nature; <http://bteam.org/planb/#scale-true-accounting>. The movement is supportive of, but distinct from, Benefit Corporations. This is a new class of corporation, established by relevant US state laws, through which businesses voluntarily commit to meeting certain standards of corporate purpose, accountability, and transparency; see www.benefitcorp.net.

2. Caux Round Table for Moral Capitalism

The Caux Round Table for Moral Capitalism is an international network of business leaders that develops intellectual strategies, management tools and best practices to strengthen private enterprise, public governance, and the positive values of the economic system; <http://www.cauxroundtable.org/>. It is currently devoting substantial attention to the role of the private sector in advancing the Sustainable Development Goals. Its Global Executive Director, Stephen B. Young, has a long-standing commitment to the development of new methodologies for company valuation that would embrace a wider range of values supportive of sustainable social justice; see his contribution "The Search for Moral Capitalism and the Holy Grail of Business Valuation," *Ivey Business Journal*, March/April 2004; <https://iveybusinessjournal.com/publication/the-search-for-moral-capitalism-and-the-holy-grail-of-business-valuation/>.

3. Coalition for Inclusive Capitalism

The Coalition for Inclusive Capitalism is a high-level initiative to make capitalism more equitable, sustainable and inclusive. Business and financial leaders examine issues such as long-term shareholder value, integrated reporting, and workforce advancement; www.inc-cap.org. Of note are its annual conferences, which aim to combine thought leadership with practical avenues for action. Its Embankment Project, described below, is particularly relevant to the challenges of company valuation. The Coalition for Inclusive Capitalism can be understood as part of a broader movement that involves organizations such as the Aspen Institute Program on Business and Society, Business for Social Responsibility, Conscious Capitalism, and indeed, the Caux Round Table. In 2016, the Saïd Business School at the University of Oxford, with financial support from the Ford Foundation, undertook a study of this movement. The resulting report, *In Pursuit of Inclusive Capitalism: Business and Approaches to Systemic Change*, is based on research and interviews with more than 40 heads of non-governmental organizations seeking to promote more inclusive approaches to capitalism; <https://www.sbs.ox.ac.uk/sites/default/files/research-projects/Images/ford-report.pdf>

4. Embankment Project for Inclusive Capitalism

The Embankment Project for Inclusive Capitalism is a key focus of the Coalition for Inclusive Capitalism. EY is taking the lead in the Embankment Project, which aims to develop a framework that measures long-term value creation for all stakeholders. In 2016, EY had prepared a white paper on the subject:

http://www.ey.com/Publication/vwLUAssets/Long_term_value_white_paper_December_2016/%24FILE/EY-LTV-white-paper-v14.pdf

An EY news release announcing the project on 28 June 2017 serves as a good summary:

The Embankment Project for Inclusive Capitalism represents an important opportunity to transform the way businesses measure and report on the value they create for stakeholders. After three years of meeting at the Conferences on Inclusive Capitalism in London and NYC, it has become clear that there will not be progress toward Inclusive Capitalism unless there is real change in the workings of the capital markets. A new reporting mechanism is required for corporations to better measure and communicate the value they create for shareholders through their strategic attention to the broad base of their stakeholders: customers, employees, communities, government, and the environment.

In furthering their commitment towards Inclusive Capitalism, EY has developed a proof-of-concept framework that will be tested and further developed by some of the world's largest asset owners, asset managers, and asset creators (corporations). The proposed framework would become a tool for asset owners and asset managers but also other stakeholders to understand, measure and compare the investments made by asset creators in their purpose, brand, intellectual property, products, employees, environment and communities.

Engagement of all parties across the investment value chain is essential to test and assess this new framework that enables companies to deliver trusted information to material stakeholders to improve the allocation of capital for the long term. We are bringing

together over 30 global companies to embark on an 18-month journey to jointly develop, test and validate the EY developed long term value framework. With the representation of almost \$30 trillion of assets under management, coupled with EY's commitment to allocate leading professionals who are dedicated to pioneering a change to the way corporate value is measured and reported, we believe that together we can act as the catalyst for meaningful change.

The collaborative project will also be supported by input from an Advisory Council of leading luminaries including academics, regulators, international standard setters, and other strategic advisors. The framework will be open sourced to achieve wide-spread adoption of the inclusive practices that can strengthen trust in business and create long term value for shareholders, and it would be a vital step toward renewing the social contract of business with society.

Our aim is to agree on a set of metrics that is underpinned by a methodology focused on outcomes for each significant area of value creation, reflecting the execution of a company's strategy and how this links to long-term financial value.

The outcome will:

Be a tool for a clearer, more comparable and more measurable articulation of how companies deliver value for all stakeholders and how this creates or protects long-term financial performance.

Where:

Asset Owners have meaningful metrics which can be incorporated into mandates and enable them to better measure the performance of assets and Asset managers and to provide a clearer way to articulate their long-term interests and set compatible short and medium-term goals to deliver these;

Asset Managers have meaningful and comparable metrics that provide better information on how assets and sectors create value enabling more informed corporate engagement, investment decisions and greater ability to engage with Asset Owners on their mandates and long-term value creation of their portfolio, as well as how that should influence their performance assessment; and

Asset Creators have a clearer and more measurable articulation of how their strategy delivers value for key stakeholders and how this translates into long-term financial value delivered through a toolbox of meaningful metrics and a tested and validated methodology.

In 2018, EY prepared a 2-page brief on its long-term value framework that succinctly lists the key challenges to overcome; <https://www.eycom.ch/en/Publications/20180327-Long-term-value/download>. These mirror many of the concerns brought out in the various entries in this review of academic literature and thought leadership on company valuation:

- Disconnect between profits and shareholder returns: profit is a short term value indicator, while shareholder returns accrue over the long term.
- Measuring the wrong things: things that can be more readily measured are typically tangible assets that are reported on the balance sheet.
- Diminishing trust in organizations: companies to demonstrate their responsible behavior actively across all aspects of their operations.

- Increased information demands reduce clarity: no fundamental re-think of how value is measured and communicated.

The publication of the Embankment Project report, expected by early next year, will make a major contribution to developing new methodologies for company valuation.

5. Focusing Capital on the Long Term

Focusing Capital on the Long Term, initiated in 2013, is now a not-for-profit organization known as FCLTGlobal; <https://www.fcltglobal.org/about/our-work>. The main aim is to encourage a longer-term focus in business and investment decision-making by developing practical tools and approaches to support long-term behaviors across the investment value chain. It describes itself as follows:

Our organization is dedicated to rebalancing investment and business decision-making towards the long-term objectives of funding economic growth and creating future savings. We take an active approach to achieving our goals by:

- Conducting research and developing practical ideas based on solid evidence
- Engaging the world's top asset owners, asset managers, and corporations to problem-solve and test capital allocation approaches that create long-term value
- Developing educational resources and actionable approaches that are available and applicable globally
- Generating measurable change in capital markets behavior among savers, investors, corporations and other stakeholders

The research staff at FCLTGlobal has prepared several whitepapers to encourage a long-term mindset, and is currently focusing on topics such as:

- Measuring progress towards long-term investment behavior using an empirical scorecard
- Alternative measures of risk and volatility
- Decision-making for capital allocation
- Innovations such as alternative trading venues and other permanent capital structures
- The investor/corporate dialogue
- The role of the corporate board

6. Forum for Sustainable and Responsible Investment

The Forum for Sustainable and Responsible Investment (US SIF) is a hub for the sustainable, responsible, and impact investing (SRI) market in the United States. US SIF attracts a broad array of members who are committed to achieving both positive societal and environmental impact and competitive returns; www.ussif.org. Its membership includes investment management and advisory firms, mutual fund companies, research firms, financial planners and advisors, broker-dealers, banks, credit unions, community development organizations, non-profit associations, and pension funds, foundations and other asset owners. It offers a range of resources on

sustainable, responsible and impact investing; the integration of environmental, social and governance (ESG) issues into investment choices; information about financial performance with SRI; as well as annual reports on Socially Responsible Investing Trends. US SIF's mission is to rapidly shift investment practices towards sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Its overall vision is for environmental, social and governance impacts to be meaningfully assessed in all investment decisions resulting in a more sustainable and equitable society. US SIF is also a member of the Global Sustainable Investment Alliance, through which it collaborates with several similar organizations around the world; <http://www.gsi-alliance.org/>

7. Future of the Corporation Project

The Future of the Corporation Project is “a major research and public engagement program aiming to develop an evidence base that will serve as a foundation to redefine business for the 21st century and build trust between business and society.” Hosted by the British Academy, this project is being led by Professor Colin Mayer, CBE, FBA, Professor of Management at the Saïd Business School, University of Oxford; <https://www.britac.ac.uk/future-corporation>. The core aims of the commissioned research are:

- To be a proactive partner in the movement for engaging a wide range of business leaders around the world to bring about positive change.
- To shape and guide policy through evidence-based recommendations for the UK and worldwide that will enable governments to support purposeful businesses.
- To influence business practice through recommendations for change that achieve profitable, sustainable outcomes.
- To influence how business is taught and researched in business schools and universities around the world.

The initial research, currently being undertaken by teams of experts based in several countries, is examining ten themes: history, trust, corporate purpose, corporate culture, technology, corporate governance, long-term investment, ownership, law, taxation and regulation, and social benefit. In addition, a series of breakfast meetings at the British Academy are yielding short briefing papers. The second phase of research will begin in early 2019. The overall Future of the Corporation program, including its continuous engagement with leaders from business, government and civil society, is sure to provide guidance on the changing parameters of company valuation.

8. Global Reporting Initiative

The Global Reporting Initiative (GRI) is an international multi-stakeholder effort for voluntary reporting of the economic, environmental and social impacts of business. It provides a repository of corporate reports in the Sustainability Disclosure Database; www.globalreporting.org. The GRI is partnering with CDP, an international non-profit organization that provides a unique global system for companies and cities to measure, disclose, manage and share vital environmental information. CDP works with hundreds of institutional investors with assets of over US \$87 trillion,

and also serves as the secretariat of the Climate Disclosure Standards Board; <https://www.globalreporting.org/information/news-and-press-center/Pages/Companies-to-benefit-as-CDP-and-GRI-collaborate-to-harmonize-reporting-frameworks.aspx>.

9. International Integrated Reporting Council

The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession, and NGOs. It has developed an international <IR> framework that focuses on value creation as the next step in the evolution of corporate reporting; <http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>. The framework sets forth the following objectives:

The IIRC's long term vision is a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by Integrated Reporting <IR> as the corporate reporting norm. The cycle of integrated thinking and reporting, resulting in efficient and productive capital allocation, will act as a force for financial stability and sustainability. <IR> aims to:

- Improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital
- Promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time
- Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

Among the IIRC's useful resources are the following:

- A background paper commissioned in 2013 on value creation:
<http://integratedreporting.org/wp-content/uploads/2013/07/IR-Background-Paper-Value.pdf>
- An ongoing series of publications called *Creating Value* that brings together trends, research, market views and case studies on <IR>.
- A recent address by IIRC council chair Professor Mervyn King, former Governor of the Bank of England: <http://integratedreporting.org/news/2018-address-by-judge-professor-mervyn-king-chairman-of-the-council-iirc/>
- A report developed in collaboration with the Association of International Certified Public Accountants, entitled *Purpose Beyond Profit*, that notes the benefits of bringing financial and non-financial information together. It provides board level insights on "the value of values:"
http://integratedreporting.org/wp-content/uploads/2018/02/Profit_Purpose.pdf

- An article that seeks to apply the traditionally proven approaches of financial reporting to the new and broader capitals framework: <http://integratedreporting.org/news/intangible-balance-sheet/>

10. Natural Capital Coalition

The Natural Capital Coalition is centered around the Natural Capital Declaration, which was launched at the UN Conference on Sustainable Development (Rio+20) in 2012; http://www.unepfi.org/fileadmin/documents/ncd_booklet.pdf. The CEOs of more than 40 financial institutions are now signatories, affirming their support for the eventual integration of natural capital considerations into financial sector reporting, accounting, and decision-making by 2020. The Declaration sets out four key commitments:

1. Build an understanding of the impacts and dependencies on natural capital relevant to our operations, risk profiles, customer portfolios, supply chains and business opportunities.
2. Support the development of methodologies that can integrate natural capital considerations into the decision-making process of all financial products and services - including in loans, investments and insurance policies. We recognize that given the diversity of the financial sector, embedding natural capital considerations will differ across asset classes and types of financial institutions. We therefore aim to build on work undertaken through other initiatives, such as the UN-supported Principles for Responsible Investment, the Equator Principles, the United Nations Environment Programme Finance Initiative (UNEP FI) Principles for Sustainable Insurance, and The Economics of Ecosystems and Biodiversity (TEEB), so that we can develop methodologies to:
 - a. Apply a holistic approach to evaluating bonds and equities through the integration of natural capital considerations in environmental, social and governance (ESG) risk analysis in short, medium and long-term growth forecasts of investee companies;
 - b. Systematically consider and value natural capital considerations in the credit policies of specific sectors, including commodities, that may have a major impact on natural capital either directly or through the supply chain;
 - c. Systematically consider and value natural capital considerations in core insurance business strategies and operations including risk management, risk underwriting, product and service development, claims management, sales and marketing, and investment management.
3. Work towards building a global consensus for the integration of natural capital into private-sector accounting and decision-making; supporting, when appropriate, the related work of The Economics of Ecosystems and Biodiversity (TEEB) for Business Coalition, and other stakeholders.
4. Collaborate, when appropriate, with the International Integrated Reporting Council and other stakeholders to build a global consensus around the development of Integrated Reporting, which includes natural capital as part of the wider definition of resources and relationships key to an organization's success.

The Natural Capital Coalition is comprised of over 270 organizations from a wide range of stakeholder groups including conservation, science and academia, business, associations, standard-setting, finance, accountancy and policy/government. Through a collaborative process

it developed the Natural Capital Protocol, launched in 2016, to make the value of natural capital visible in business decision making; https://naturalcapitalcoalition.org/wp-content/uploads/2018/05/NCC_Protocol_WEB_2016-07-12-1.pdf. The Protocol offers a standardized decision-making framework that allows businesses to identify, measure and value their direct and indirect impacts and dependencies on natural capital. The Coalition, in association with the University of Cambridge Institute for Sustainability Leadership, also implemented a Natural Capital Protocol Application Program. This supported businesses in their use of the Natural Capital Protocol and relevant sector guides; <https://naturalcapitalcoalition.org/protocol/protocol-application-program/>

11. Natural Capital Finance Alliance

The Natural Capital Finance Alliance (NCFA) is a collaboration between the UN Environment Programme Finance Initiative and the financial sector to lead the integration of natural capital considerations into financial decision-making; <http://www.naturalcapitalfinancealliance.org>. The NCFA aims to drive innovation and develop the practical tools that enable financial institutions to better understand risks, pursue opportunities, and establish the foundations for resilient long-term economic growth. The NCFA has developed a series of resources to support such assessments, enabling financial sector to better understand - at both asset and portfolio level - the risks and opportunities associated with natural capital. In April 2018, the NCFA, alongside the Natural Capital Coalition and the Dutch Association of Investors for Sustainable Development (VBDO), launched a supplement to the Natural Capital Protocol. See <http://www.naturalcapitalfinancealliance.org/finance-sector-supplement>; and also the press release, [Connecting Finance and Natural Capital: A Supplement to the Natural Capital Protocol](#). The Supplement aims to help financial institutions incorporate natural capital impact and dependency considerations into their lending, investment and insurance practices. It recognizes that the deterioration of the natural systems that underpin the global economy may pose significant consequences for many businesses, and subsequently, for those who have financed or insured them. The Supplement will guide financial institutions through the process of identifying, measuring and valuing material risks and opportunities as a means of informing financial decision making.

12. Organization for Economic Cooperation and Development

The Organization for Economic Cooperation and Development (OECD) supports significant initiatives related to the private sector, including in corporate governance, anti-corruption, and the OECD Guidelines for Multinational Enterprises. It hosts an annual forum on Responsible Business Conduct, which in 2017 considered how responsible business conduct contributes to the SDGs; <http://mneguidelines.oecd.org/global-forum/2017-GFRBC-Session-Note-Contributing-to-SDGs.pdf>. In 2018, the forum focused on due diligence; <http://mneguidelines.oecd.org/global-forum/2018-global-forum-responsible-business-conduct.htm>.

Of potential interest with respect to company valuation is the work of the OECD on achieving well-being and inclusive growth; <http://www.oecd.org/statistics/measuring-well-being-and-progress.htm>. The OECD has established a High-Level Expert Group on the Measurement of

Economic Performance and Social Progress. There is also an emerging focus, advanced through a series of workshops, on the role of private sector in shaping good outcomes for individuals, communities and societies; for example, <https://www.oecd.org/statistics/Biz4WB-Highlights-OECD.pdf>. A key issue is how a well-being and inclusive growth approach can be fully integrated into business models and measurement frameworks, giving voice to business leaders who are setting a new course to foster more sustainable and people-minded strategies. Further impetus to these efforts will be provided at the 6th OECD World Forum on Knowledge, Statistics and Policy, to be held in Korea in November 2018; <https://www.oecd-6wf.go.kr/eng/main.do>. The overall Forum theme is “The Future of Well-being,” and part of the agenda is dedicated to measuring the impact of business on well-being and sustainability. The call for research presentations included questions such as: Has the change in reporting under frameworks such as GRI and SASB translated into a change in business performance, and if so, in what ways (*e.g.*, financial, societal)? How do firms adapt to an environment of increasing demands on measuring their impact? Are there trade-offs and/or complementarities between societal and economic performance? Are investors adapting their portfolios in a way that reflects the new information that goes beyond financial performance to the impact on people’s well-being? The findings of this OECD initiative might inform certain questions related to company valuation.

13. Principles for Responsible Investment

Principles for Responsible Investment (PRI) is an international network of institutional investors that have committed to upholding a set of principles; www.unpri.org. Initially developed by the UN Global Compact and the UN Environment Programme, these principles acknowledge the materiality of environmental, social and governance (ESG) issues in investment decision-making and ownership practices. Also recognized is their potential role in better aligning investors with broader societal objectives. The Principles of Responsible Investment provide as follows:

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

The PRI offers a comprehensive range of resources organized under the headings of environmental, social and governance topics. It hosts a collaboration platform, as well as a range of conferences and practical training programs for the industry. Moreover, it convenes a global academic research network that focuses on innovative responsible investment projects. For example, in April 2018, it showcased a report on how ESG engagement creates value for investors and companies; <https://www.unpri.org/asset-owners/academic-research>.

14. Professional and Financial Firms and Associations

An important source of thought leadership on new approaches to company valuation is found within global consulting and accountancy groups, financial services firms, and related industry associations. By way of example, such contributions include:

- Aviva, as a multinational insurance and investment group, is engaged in a number of initiatives in the field of sustainable finance – such as a report on the private sector contribution to financing the SDGs; <https://www.aviva.com/social-purpose/sustainable-finance-and-the-sdgs/>. Aviva is also leading a collaborative effort to advance a World Benchmarking Alliance; www.worldbenchmarkingalliance.org. This includes the development of a corporate sustainability benchmark, ranking companies on their sustainability performance and contribution to the SDGs.
- Boston Consulting Group has developed Total Societal Impact (TSI) as a new lens for company strategy, in relation to the traditional approach of maximizing total shareholder return (TSR); https://www.bcg.com/Images/BCG-Total-Societal-Impact-Oct-2017-R_tcm38-174019.pdf.
- The Convention of Independent Financial Advisors (CIFA), is a non-profit Swiss foundation concerned with finance, asset management and global financial counseling; <http://www.cifango.org/>. CIFA enjoys General Consultative Status with the UN Economic and Social Council, and has a long-standing interest in the relationship between finance and the broader social good.
- EY has established the Beacon Institute, a community of business leaders, board members and academics focused on helping organizations create long-term value and navigate the disruptive forces shaping the 21st century. The Beacon Institute provides research, insights and advice aimed at the growing movement of purpose-led businesses. It also seeks to bring together early adopters and leading thinkers who have embraced purpose as a means to drive real change in the working world; <https://www.ey.com/gl/en/issues/ey-beacon-institute>.
- KPMG True Value, introduced in 2015, is a tool that aims to connect corporate and societal value creation. An understanding of how the value a business creates and reduces for society is likely to affect the value it creates for shareholders provides a new lens for decision-making. As a project summary explains:

KPMG True Value is a 3-step process that can be applied across sectors and geographies. It is scalable and can be applied to a whole company, a division or a specific project.

Step 1: Identify the value a company creates and reduces for society through its externalities and express this in financial terms

Step 2: Assess how the internalization of externalities is likely to affect future earnings (through regulation, stakeholder action and market dynamics)

Step 3: Develop business cases that build and protect future value for shareholders by increasing the value created for society.

For a company, the potential benefits of using the tool are to improve performance, inform strategy, and increase influence;

<https://home.kpmg.com/content/dam/kpmg/ae/pdf/introduction-kpmg-truevalue.pdf>.

15. Re-Evaluation of the Capitalist System

In recent years, a series of books has offered a re-evaluation of the capitalist system from a variety of critical perspectives. Often aimed at professional as well as popular audiences, such works provide insights supportive of new approaches to company valuation. Some common themes include: historical grounding in works by Adam Smith, Karl Marx, Max Weber, Milton Friedman and others; challenges to the free market; the dynamics of globalization and international trade; causes and consequences of the 2008 Global Financial Crisis; geopolitical and systemic threats; corporate purpose and governance; corporate values, ethics and social responsibility; accountability and enforcement; the nature of work; executive compensation; reinvention of the corporation; shareholders and stakeholders; social and economic inequality; erosion of trust; industrial restructuring; internalization of externalities; the role of business leadership.

Publications of note include:

- Barnes, Kenneth J. (2018), *Redeeming Capitalism*. Grand Rapids, MI: Wm. B. Eerdmans Publishing Co.
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- Young, Stephen B. (2015), *The Road to Moral Capitalism*. Cardiff, CA: Waterside Productions, Inc.

16. SIGMA Project – The Five Capitals

The SIGMA Project, which stands for “Sustainability—Integrated Guidelines for Management,” was founded in 1999 through a partnership between the British Standards Institution, Forum for the Future, and AccountAbility; <http://www.projectsigma.co.uk/default.asp>. It marks an early effort to describe the five capitals -- natural, human, social, manufactured, and financial -- and apply them to business practice. The following links help illustrate the conceptual development of the five capitals through these organizations, as well as through the International Integrated Reporting Council (IIRC, as described above):

- <http://www.projectsigma.co.uk/Guidelines/Principles/Capitals/The5Capitals.asp>.

- <https://www.forumforthefuture.org/Handlers/Download.ashx?IDMF=8cdb0889-fa4a-4038-9e04-b6aefefe65a9>
- <http://www.accountability.org/standards/>
- <http://integratedreporting.org/wp-content/uploads/2013/03/The-Capital-Methods-of-literature-review-and-sources.pdf>
- <http://integratedreporting.org/wp-content/uploads/2013/03/The-Capitals-Visuals-of-alternative-models-of-capitals-.pdf>
- <https://www.tellus.org/pub/The%20Five%20Capitals%20of%20Integrated%20Reporting-Toward%20a%20Holistic%20Architecture%20for%20Corporate%20Disclosure.pdf>

17. Smith School of Enterprise and the Environment

The Smith School of Enterprise and the Environment (SSEE), founded at the University of Oxford ten years ago, is a global center of excellence for research, teaching and corporate engagement on questions of climate change and sustainability; <http://www.smithschool.ox.ac.uk>. Its program areas include Sustainable Finance as well as the Economics of Sustainability. A key collaboration involves the Oxford Martin School, which has promulgated the Oxford Martin Principles for Climate-Conscious Investment; <https://www.oxfordmartin.ox.ac.uk/publications/view/2637>. These Principles provide a framework for engagement between climate-conscious investors and companies across the global economy. Building upon the science of long-term climate change, they focus on how investments contribute to the global stock of cumulative carbon dioxide emissions, complementing other measures, such as carbon foot-printing, that focus on emission flows.

A report issued in 2015, co-authored and funded by Arabesque Asset Management, is especially relevant to this review of collaborative thought leadership on company valuation. It is entitled: *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance*. Moreover, it includes bibliographic entries for more than 200 sources. The abstract for the Social Studies Research Network (SSRN) provides as follows:

Abstract:

In this enhanced meta-study we categorize more than 200 different sources. Within it, we find a remarkable correlation between diligent sustainability business practices and economic performance. The first part of the report explores this thesis from a strategic management perspective, with remarkable results: 88% of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cashflows. The second part of the report builds on this, where 80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance. This report ultimately demonstrates that responsibility and profitability are not incompatible, but in fact wholly complementary. When investors and asset owners replace the question “how much return?” with “how much sustainable return?”, then they have evolved from a stockholder to a stakeholder.

Note:

From the Stockholder to the Stakeholder was co-authored by the Smith School of Enterprise and the Environment at the University of Oxford and Arabesque Asset Management. Funding was provided by Arabesque Asset Management.

Keywords:

Sustainability, Corporate Social Responsibility, ESG, financial performance, cost of capital

Suggested Citation:

Clark, Gordon L. and Feiner, Andreas and Viehs, Michael, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (March 5, 2015). Available at SSRN: <https://ssrn.com/abstract=2508281>

18. Social and Human Capital Coalition

The Social and Human Capital Coalition was launched in April 2018, based on the conviction that the measurement and management of corporate performance must evolve to incorporate social and human capital; <http://social-human-capital.org/sites/default/files/SHCC%20-20media%20release%20FINAL.pdf>; see also main website: <http://social-human-capital.org>. Alongside financial and environmental metrics, there is growing momentum for the development of a credible, comparable approach to such valuation. This will help companies to better manage their social risks and integrate social impact into their core business strategies. Nonetheless, the Coalition observes that there is currently little consensus on how companies should measure and value intangible assets such as social and human capital. As a result, companies often under-value and under-invest in them. A key aim is to promulgate a “Social and Human Capital Protocol” that would clarify the objectives and mechanics of valuation. An initial task, given these ambiguities, was to draft a “Social and Human Capital Charter” to frame the Protocol and guide companies and stakeholders; <http://social-human-capital.org/introducing-social-human-capital-coalition/social-human-capital-charter>. The articles of the Charter address: Sustainable Development; Human Rights; Transparency; Trade-offs; Monetary Valuation; Role of governments, society and communities; Continuous learning and adaptive management. As the Coalition explains:

The purpose of this Charter is to highlight key ethical issues that should be considered by users of the Protocol, to help ensure that the application by business of the concept of social capital through the Protocol leads to the protection, maintenance and, where possible, enhancement, of people’s rights, skills, experience, knowledge, and well-being in addition to societies’ shared values, norms and institutions.

A draft of the Social and Human Capital Protocol has been developed by the World Business Council for Sustainable Development (WBCSD), along with an expert Advisory Group of over 20 companies; http://docs.wbcd.org/2017/04/Social_Capital_Protocol_Guide.pdf. Peter Bakker, President and CEO of the WBCSD, serves as the Coalition’s Chair in 2018-2019 (see WBCSD entry below). The Protocol aims to help business measure and value intangible assets such as skills, competencies, consumer trust and the importance of establishing closer relationships with regulators and local communities.

An extensive stakeholder consultation has recently been completed, and a collection of documents, research reports and case studies is now available on the website. Of note is “Social Capital – An Eclectic Literature Survey,” commissioned by the Tata Sustainability Group; https://docs.wbcsd.org/2018/09/Social_Capital-An_eclectic_literature_survey.pdf. A new version of the Social & Human Capital Protocol will be launched in the first quarter of 2019.

19. Sustainability Accounting Standards Board

The Sustainability Accounting Standards Board (SASB), established in 2011, is an independent private-sector standards setting organization based in San Francisco, California: <https://www.sasb.org/>. It is dedicated to enhancing the efficiency of capital markets by fostering high-quality disclosure of material sustainability information that meets investor needs. The SASB develops and maintains sustainability accounting standards – for 79 industries in 11 sectors – that help public corporations disclose financially material information to investors in a cost-effective and decision-useful format. The SASB’s transparent, inclusive and rigorous standard-setting process is materiality focused, evidence-based and market informed. As the SASB Navigator explains; <https://navigator.sasb.org/>:

In a marketplace saturated with sustainability information, it’s hard to know what to trust and how to decipher what really matters—which factors will drive performance and impact the bottom line. SASB sharpens the focus. With SASB’s industry-specific standards, access the research that explains which ESG factors are most likely to create — or destroy — value. And take it a step further by comparing the quality of corporate disclosures on those factors.

20. Sustainable Stock Exchanges

Sustainable Stock Exchanges (SSE) is an initiative of UNCTAD, UN Global Compact, UN Environment Programme Finance Initiative and the UN-supported Principles for Responsible Investment; <http://www.sseinitiative.org/>. Launched in 2009 by the United Nations Secretary-General, it serves as a peer-to-peer learning platform for exploring how exchanges (in collaboration with policymakers, regulators, investors and companies) can promote responsible investment for sustainable development. It encourages partnerships and the adoption of best practices. A 2017 report, *How Stock Exchanges Can Grow Green Finance: A Voluntary Action Plan*, has a special focus on the implementation and financing of the SDGs; <http://www.sseinitiative.org/wp-content/uploads/2017/11/SSE-Green-Finance-Guidance-.pdf>. It examines issues of relevance to stock exchanges, such as government commitments to “design policies, including capital market regulations where appropriate, that promote incentives along the investment chain that are aligned with long-term performance and sustainability indicators, and that reduce excess volatility.” The report also cites several evidence-based studies that evaluate quality of earnings, quality of financial reporting and continuity of risk-adjusted returns by companies that adopt ESG or sustainability measures. These findings indicate that ESG measures more broadly could be used to rationalize the quality of earnings and financial reporting, and improve the fundamental valuation of debt and equities.

21. UK Financial Reporting Council

In recent years, the field of corporate governance has generated substantial attention from policy-makers, business and financial leaders, legal and accounting professionals, civil society advocates, academics, and other stakeholders. Jurisdictions around the world are considering the scope of corporate board responsibility on questions ranging from purpose to accountability to strategic risk management. This includes a range of environmental, social and governance (ESG) issues often driven by financial investors. Questions of company reporting and valuation are also on the agenda. By way of example, an extensive consultation process took place under the auspices of the UK Financial Reporting Council (FRC). In July 2018, the FRC released a new UK Corporate Governance Code and the updated Guidance on Board Effectiveness:

<https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF>

<https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF>

Within the FRC Guidance, the section on board leadership and company purpose includes the following paragraph of relevance to evolving frameworks for company valuation:

A sound understanding at board level of how value is created over time is key in steering strategies and business models towards a sustainable future. This is not limited to value that is found in the financial statements. An understanding of how intangible sources of value are developed, managed and sustained – for example a highly trained workforce, intellectual property or brand recognition – is increasingly relevant to an understanding of the company's performance and the impact of its activity. These are important considerations for boards when setting corporate strategy.

Ongoing analysis and activity, notably on the part of professional services firms and industry associations, will contribute to the advancement of sustainable value creation and measurement.

22. United Nations Global Compact

The UN Global Compact (UNGC), established in 2000, is the world's largest voluntary corporate responsibility initiative. The main purpose is to encourage companies to support a core set of values in areas of human rights, labor rights, environment and anti-corruption. Sustainable development has become a key area of focus, and the UNGC has compiled an extensive collection of resources and toolkits to facilitate business engagement with the SDGs; www.unglobalcompact.org. It has recently launched a new blueprint for business leadership on the SDGs that aims to inspire all companies – regardless of size, sector, or geography – to take action; <http://blueprint.unglobalcompact.org/>. A series of SDG Briefs helps companies identify suitable strategies. Under Goal 17 on partnerships, for example, there is guidance on how to galvanize private sector financial support for initiatives in developing countries.

23. United Nations Sustainable Development Agenda

As noted in the introduction to this document, the UN Sustainable Development Goals (SDGs) have catalyzed research and action in numerous areas that will impact the future of company valuation. A key document is *Transforming our World: The 2030 Agenda for Sustainable Development Agenda*. This is the title of the UN resolution, adopted in September 2015 and spanning until 2030, which sets forth the Sustainable Development Goals and targets; <https://sustainabledevelopment.un.org/content/documents/21252030%20Agenda%20for%20Sustainable%20Development%20web.pdf>. The UN work stream on financing for development -- dubbed the *Addis Ababa Action Agenda* -- is an integral part of the Sustainable Development Agenda. This establishes a vital foundation to support the implementation of the SDGs. It also aims to provide a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social and environmental priorities. As such, it is of particular relevance to this review; https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf.

The final version of this document will identify several recent initiatives and policy proposals of potential relevance to company valuation. These will be drawn from key developments in areas such as Engagement of the Private Sector; Measurement of Progress and Social Impact; Alignment of Private Finance with the SDGs. Again, thought leadership is at the fore – at times cutting across each of these areas. For example, the UN Social Impact Fund has been established at the UN Development Programme’s regional headquarters in Bangkok, Thailand; <http://undp.socialimpact.fund/unsif-research-council/>. An international research council, comprised of leading academic institutions, has been convened to conduct theoretical and applied research. It is examining the alignment of private capital markets with the SDGs, including the development of metrics to measure impact investing; <http://undp.socialimpact.fund/2017/09/22/undp-announces-partnership-with-top-universities-to-set-development-yardstick-for-impact-investing/>.

24. World Bank Group Human Capital Project

In August of 2018, the World Bank Group announced a new Human Capital Project to help countries prioritize human capital in a sustained way, recognizing that jobs and skilled workers are key to national progress in countries at all income levels; <https://www.worldbank.org/en/news/immersive-story/2018/08/03/investing-in-people-to-build-human-capital>.

It noted:

There are three main objectives: first, to build demand for more and better investments in people; second, to help countries strengthen their human capital strategies and investments for rapid improvements in outcomes; and third, to improve how we measure human capital. The new Human Capital Index, to be released at the World Bank’s Annual Meetings in October, will support all three objectives and offer a crucial resource for both governments and citizens. It will help measure productivity-related human capital outcomes such as child survival, early hardwiring of children for success, student learning, and adult health.

World Bank Group President Jim Yong Kim provides further context in the July/August 2018 issue of *Foreign Affairs*; <https://www.foreignaffairs.com/articles/2018-06-14/human-capital-gap>. His article is entitled: “The Human Capital Gap: Getting Governments to Invest in People.” Additionally, this priority is reinforced in the upcoming 2019 edition of the World Bank’s flagship publication -- *World Development Report: The Changing Nature of Work*; <http://www.worldbank.org/en/publication/wdr2019>.

Overall, this Human Capital Project will help reinforce the importance of building and measuring intangible assets, and thus may yield insights for understanding such elements within company valuations. Similar benefits may be derived from the World Economic Forum effort described below.

25. World Business Council for Sustainable Development

The World Business Council for Sustainable Development (WBCSD) is a group of international companies and business organizations that promotes policies and best practices for sustainable development; www.wbcsd.org. Its “Redefining Value” initiative is especially relevant to contemporary challenges in company valuation; <https://www.wbcsd.org/Programs/Redefining-Value>. The WBCSD describes the effort as follows:

Redefining Value helps companies measure and manage risk, gain competitive advantage and seize new opportunities by understanding environmental, social and governance (ESG) information.

We do this by building collaborations and developing tools, guidance, case studies, engagement and education opportunities to help companies incorporate ESG performance into mainstream business and finance systems.

Our goal is to improve decision-making and external disclosure, eventually transforming the financial system to reward the most sustainable companies.

The Redefining Value initiative is forging creative approaches to investment decision-making. For example, a recently announced project seeks to help companies align retirement assets with sustainability;

<https://www.wbcsd.org/Programs/Redefining-Value/Investor-decision-making/Aligning-Retirement-Assets/News/initiative-to-help-companies-align-retirement-assets-with-sustainability>. As noted above, the WBCSD is also a leader in the Social and Human Capital Coalition.

26. World Economic Forum Global Human Capital Index

The World Economic Forum (WEF), established in Switzerland in 1971, promotes public-private cooperation by engaging political, business and other leaders of society to shape global, regional and industry agendas. One effort of relevance to company valuation centers on human capital – the ingenuity and creativity to solve current challenges and build a future that is more inclusive and human-centric. According to the WEF *Global Human Capital Report 2017*, how nations develop their human capital can be a more important determinant of their long-term success than virtually any other factor;

http://www3.weforum.org/docs/WEF_Global_Human_Capital_Report_2017.pdf.

The Report proposes a new benchmark for maximizing this potential:

The Global Human Capital Index 2017 ranks 130 countries on how well they are developing their human capital on a scale from 0 (worst) to 100 (best) across four thematic dimensions and five distinct age groups to capture the full human capital potential profile of a country. It aims to be used as a tool to assess progress within countries and point to opportunities for cross-country learning and exchange.

Concluding Observations from the Caux Round Table

Reflections on Valuation

The valuation of firms, most unfortunately, is a small, secluded, corner of our modern global capitalism. So frequently is the value of a firm, a readily proffered proxy for its future prospects, taken from market prices -- either from the price of its shares or from the sale of a comparable entity. Rarely, however, is the value of a firm taken from its net asset value as shown on audited balance sheets.

Though valuation is often an arcane art left to professionals, price discovery is said to be the heart of capitalism. Price discovery pumps material information through markets, facilitating the closing of transactions between willing buyers and sellers. If price is so important to the flourishing of market transactions, and firms or equity interests in them are bought and sold through such transactions, then no attempt should be overlooked to arrive at a sound estimate of what a company is worth.

Two considerations are important. First, prices convert inchoate demand for goods and services into the wealth of nations. As Adam Smith wrote, the gaining of meat, beer or bread by the consumer and of money by the butcher, the brewer or the baker occurs when a price for meat, beer or bread is acceptable to both seller and buyer. An off-kilter price does not lead to an exchange of values, with profit for the seller and satisfaction for the buyer. To promote business, finance, and commerce, we need to pay close attention to prices. If prices are too high, demand dies away; if they are too low, supply dries up. Prices serve as checks and balances keeping supply and demand in sync with one another. We enhance wealth creation by getting prices right.

Second, prices “moralize” self-interest. If a market transaction happens voluntarily through the operation of free will, it is because the values of a seller and the values of a buyer coincide in finding a price acceptable to each. At that price, mutuality occurs. Morality arises as mutual agreement comes about. Self-interest is transcended and becomes something more communal. Two independent interests with their various value components merge into a social fact. Two independent wills merge into a common good.

To find the price which will permit the morality of markets to come about, we need to unpack all the components of value which the parties use to set their preferences. As economists would say, to set their utility curves for a good, a service, money, or whatever else is embraced by the contract of exchange. Reference to Abraham Maslow’s hierarchy of needs may be apt in understanding how an individual’s utility curve is shaped, how he or she acts on a perceived preference, satisfaction or disdain. This may reflect some combination of an individual’s so-called first order needs for basic sustenance, shelter and security and the higher order needs for self-expression and meaning. The latter are found in psycho-social merit goods such as status and esteem; belongingness, love, compassion, generosity, and empathy; appreciation of art; creative accomplishment, and even concern for legacy after death. Intangible considerations -- over and above food and shelter, money and rank -- shape our willingness to pay more or less for a good or service. In essence, many values contribute to a market value.

The same holds true for firms. The price of a firm, its value expressed in money, reflects many factors, both tangible and intangible.

Market prices for firms do not always provide reliable information as to their long-term value. Market prices, as we learned from the collapse of credit markets in 2008, are only nominal. A market price at one moment may not be there at another point in time. The price could rise or fall depending on the value assessments brought to the market by buyers and sellers.

The implication of this, for those who seek longer-term stability in asset prices, is to intellectually put market prices in perspective and supplement them with a different basis for analysis or worth.

Pricing and Sustainability

Sustainability can be impeded or advanced by pricing. If sustainable firms have more value than unsustainable ones due to lower long-term risk profiles, then they merit investment from those seeking reliable returns. Conversely, unsustainable firms do not deserve investment due to their higher risk of future loss and failure.

The challenge for any present-market pricing of firm value is whether or not nominal market prices are correct indicators of future performance and long-term sustainability. For such pricing to more reliably represent the long-term prospects of a firm, those factors which contribute to or detract from sustainability must be included in the calculation of price.

How is this to be done? This report draws attention to emerging paradigms of company valuation for long-term social and environmental sustainability.

Enterprise risk gravitates towards how well or poorly a firm engages with its many stakeholders – customers, employees, providers of financial capital whether through equity or debt, suppliers, regulators, civil society opinion-leaders and norm-setters. Seeking a reliable present value for a firm should include an effort to estimate the consequences, over time, of the firm's ability to benefit from its engagement with stakeholders.

As shown in Part One (Sec. 1) of this literature review, current conventions on the process of setting a valuation for a firm do not explicitly or formally include assessments of a firm's engagement with all its stakeholders.

The same conclusion is reached inversely in Part One (Sec. 2), which outlines emerging metrics for firm valuation. The emerging metrics are seeking out, groping in the faint light of an early intellectual dawn perhaps, for a new methodology of valuation. The search for something new and better reveals dissatisfaction with the status quo in valuation methodology, exposing its limitations.

Finally, the thought leadership initiatives presented in Part Two of the report offer a range of potential approaches to the development of a viable and comprehensive valuation methodology.

The report establishes a baseline of current practice in valuation and points the way with reason and insight towards a new sophistication in assessment of firm prospects. Going forward, this is quite in keeping with the needs of a sustainable global capitalism.