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PEGASUS

A NEWSLETTER FOR THE CAUX ROUND TABLE FOR MORAL CAPITALISM NETWORK LOOKING AT BUSINESS ABOVE THE CLUTTER AND CONFETTI

Pegasus

Introduction

The Caux Round Table for Moral Capitalism (CRT) has convened a series of round tables to gain insights on the topic of valuation methodology. Our initial conviction is that it is valuation of a firm – a capitalization multiplier applied to its net present discounted value of future income – which best incorporates measures of ethical responsibility towards all stakeholders and traditional metrics for periodic profitability. Thus, a modern method for valuing a firm would permit sophisticated management of a "moral capitalism" and enhance sustainability of the enterprise.

The proceedings of each round table will be integrated into a report with recommendations for changing valuation methodology.

This issue of Pegasus brings you the proceedings from round tables in Sydney, Amsterdam and San Francisco.

Why convene discussions on valuation? We have been asking in various ways in recent years what is the "middle term," to borrow from Aristotle's logic, which makes the necessary link between purpose and profit?

The proof of a syllogism is the connecting idea, such as in the old example:

> Major premise: All **men** are mortal.
> Minor premise: Socrates is a **man**.
> Conclusion: Socrates is mortal.

We are thinking that profits are the functional equivalent of a middle term for capitalist enterprise. The long-term objective of enterprise is wealth creation, an asset or balance sheet concept. Profits are an interim step between risk assumption and wealth creation. Net profits accumulate into assets when the enterprise is successful. Profits in any one accounting period are no indication of either future profits or the firm's net present capital value.

The major premise is that enterprise purpose is to turn profits into assets. The minor premise is that profits arise from good risk management of stakeholder relationships. The conclusion is that profits can be turned into assets, which accomplishes purpose.

Thus, we should shift our financial paradigm in capitalism from profit-seeking to asset accumulation.

Once we think in terms of assets, we are directed to act with regard for the long-term or out of enlightened self-interest, also called by ethicists our "self-interest considered upon the whole."

The recent statements on the purpose of enterprises from the Business Roundtable and the World Economic Forum confirm the CRT's Principles of 1994 that purpose and profits are tied together by enterprise. Risk-taking with a purpose leads to profits. Profits earned from providing meritorious public and private goods are worthy and a social good.

Assets are needed to support risk and innovation. Assets need to be replenished to keep the enterprise operating as a going concern.

The problem is that our accounting conventions frustrate comprehensive asset-based thinking.

Balance sheets are still mostly conceived as putting numbers to tangible assets – various forms of ready cash, I would say. Balance sheets leave out intangible factors of reputation, IP, productivity, culture, governance and human capital, thus failing to portray the real prospects of an enterprise.

Consider, today, the gap in nearly every case between a public company's balance sheet net worth and its market capitalization. Balance sheets are not so helpful in investment planning, especially on the equity side.

In the current issue of The Economist, an editorial on what should be expected from CEOs raised the importance of valuation:

> *Today, however, 32% of firms in the S&P 500 of big American firms invest more in intangible assets than physical ones and 61% of the market value of the S&P 500 sits in intangibles, such as research and development, customers linked by network effects, brands and data. The link between the CEO authorizing investment and getting results is unpredictable and opaque. What, then, does it take to be a corporate leader in the 2020s? Every firm is different, but those hiring a CEO or aspiring to be one should prize a few qualities. Mastering the tricky, creative and more collaborative game of allocating intangible capital is essential. A CEO must be able to marshal the data flowing between companies and their counterparties, redistributing who earns profits and bears risk.*

We have a concept paper available setting forth our thoughts and a background report on the state of the art in valuation analysis, which I commissioned from Oxford Analytica.

Stephen B. Young
Global Executive Director
Caux Round Table for Moral Capitalism

Round Table on Valuation
Proceedings
Sydney, Australia
May 14, 2019

Westpac Bank hosted a round table on valuation at its headquarters in Sydney, Australia, on May 14, 2019. Carolyn McCann, Group Executive, Customer & Corporate Relations and Siobhan Toohill, Group Head of Sustainability, convened the discussion. Noel Purcell, Chairman Emeritus of the Caux Round Table for Moral Capitalism (CRT) and former executive for Westpac in its stakeholder governance, marketing and corporate communications functions, attended. Jack Flanagan, Emeritus Professor of Accounting at Australian Graduate School of Management, University of New South Wales, Sydney, participated as a guest of the CRT.

Given the recent report by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the round table discussion returned again and again to the problem of giving financial institutions an asset "value" in the public mind as a force for good. Having financial institutions recognized for having such a "social" asset value would imply that such firms deserve a "license from society" to carry out their business activities and to prosper for the good of all.

Participants drew the inference that an institution such as Westpac needs to support its contribution to Australia as an "asset" for its future flourishing, more than as a transactional force taking in cash profits from the society and giving out "impacts," good and bad, for the country and its economic, cultural, political and natural environments.

There was agreement that our current ways of measuring economic results narrowly but also separately from non-financial impacts (GRI, triple bottom line, sustainability reports, SDG scorecards and dashboards, social, human and natural capital protocols, integrated reporting formats, etc.) do not provide an over-all net "value" of a firm as an institution drawing upon and contributing to its human and natural ecologies.

After the round table, Prof. Flanagan sent me a reference to a reporting format suggested in the 1970s of "value added statements" as an expanded version of P&L statements which attempt to report on the resources used by a company to produce a range of outcomes.

He sent me the following recent 2017 value added statement of Volkswagen:

The value added statement indicates the added value generated by a company in the past fiscal year as its contribution to the gross domestic product of its home country and how it is appropriated. Due to the improved operating profit before special items and lower negative special items, the value added generated by the Volkswagen Group in the reporting period was up 16.8% year-on-year. Added value per employee increased to €107.7 thousand (+13.9%) in 2017. Employees in the passive phase of their partial retirement as well as vocational trainees are not included in the calculation.

VALUE ADDED GENERATED BY THE VOLKSWAGEN GROUP

Source of funds in € million	**2017**	2016
Sales revenue	230,682	217,267
Other income	18,912	17,907
Cost of materials	−151,449	−140,307
Depreciation and amortization	−22,165	−20,924
Other upfront expenditures	−17,615	−23,990
Value added	**58,364**	**49,953**

Appropriation of funds in € million	**2017**	**%**	**2016**	**%**
to Volkswagen AG shareholders (dividend, 2017 dividend proposal)	1,967	3.4	1,015	2.0
to employees (wages, salaries, benefits)	38,950	66.7	37,017	74.1
to the state (taxes, duties)	3,433	5.9	3,486	7.0
to creditors (interest expense)	4,344	7.4	4,070	8.1
to the Company (reserves)	9,671	16.6	4,365	8.7
Value added	**58,364**	**100.0**	**49,953**	**100.0**

The round table noted the following concerns:

1) Complexities of operational risks – risk assessments have their limitations.

2) What risks are material and so deserve board consideration?

3) Role of the board in stewardship of firm asset values?

4) Good risk management deserves reflection in the present valuation of a firm and conversely, poor risk management should de-value current prospects for a firm.

5) As a research approach for a material area of operations, a reasonably likely scenario should be projected and its impacts on future cash flows estimated.

6) Trust is a capital asset of every firm which is not currently set forth for management action, either quantitatively or qualitatively.

7) The mega trend today for business is the transformation of its ecosystem from a relationship world of stakeholder/firm engagements to a transactional one using more and more impersonal exchanges of data via computers. Firms are thus becoming more and more remote from stakeholders and can more easily take them for granted until social media demands remediation of shortcomings. As large firms in particular turn inward in their decision-making dynamics, they become victim to the inertia of self-absorption.

Round Table on Valuation
Proceedings
Amsterdam, The Netherlands
June 25, 2019

ABN AMRO, the Impact Institute and the Caux Round Table for Moral Capitalism (CRT) jointly convened a round table discussion of valuation and impact assessments for companies.

A general conclusion from the presentations and discussion was the standard for a new capitalism of "from us all, for us all, by us all." The renewed capitalism should stimulate long term value creation for all stakeholders. To integrate long-term value creation in decision-making, companies need to measure, report and steer on impact and embed stakeholder influence. In doing so, the Sustainable Development Goals (SDGs) provide a clear language and objective.

Steve Young, Global Executive Director of the CRT, opened the discussion with a presentation on the work of the CRT in formulating a new theory of the firm which includes intangible capitals such as social capital, human capital, reputation capital and intellectual capital. The use of such capital accounts permits recording long-term the availability of resources necessary for sustained firm success. By creating more comprehensive balance sheet accounting, owners and investors can focus on long-term impacts of firm behavior more than is possible when only profit and loss statements are used to steer enterprise decision-making.

Adrian de Groot Ruiz of the Impact Institute then described the institute's recommendation that firms use impact statements in addition to financial statements. By directing focus to the "impacts" of firm behavior, such statements will enhance steering the company towards long- term value creation for itself, including its shareholders and for society at large. The impact statement internalizes the quantity and quality of the firm's outputs, overcoming past difficulties in bringing future externalities into firm decision-making, thus overcoming a long-standing failure of micro-economics.

Adrian asked: what variables should be used to "steer" a company forward? Profit or a multiple of outcomes?

The proposed impact statements provide context: contributions (and risks) to value for investors, net value creation for each stakeholder constituency, a do-no-harm ethic for firm decision-making and contributions to the SDGs.

It should be noted that the impact statements validate the relevance of the CRT Principles for Business, specifically the first two principles.

Third, Tjeerd Krumpelman of ABN AMRO described his bank's work in drawing up an impact statement for 2018. The effort enhanced integrated thinking and reporting. It improved bank decision-making, made explicit growth in capitals contributing to a better society and gains or losses to sustainability. The impacts recorded could be easily associated with one or more of the SDGs.

Professor Dirk Schoenmaker then argued for the central importance of governance. Governance mechanics steer the integration of thinking and multi-factor analysis of the economic, society and biosphere.

A point was then made that "steering" a company is the challenge.

Yet, steering towards what beach? Many search for a financial "landing" for their company boat which is outperformance of the market in the generation of cash flow.

Pension funds do have long-term horizons for their investment objectives which are limited in concern for the wealth effects on those to be supported financially in their older years.

Former Dutch Prime Minister Jan Peter Balkenende advised that the standards needed to assist private companies in contributing to implementation of the SDGs should be: global in applicability; measurability (measurements are necessary for governance, just as a compass facilitates steering a boat to the desired destination); a change in mindset as to the purpose and modalities of capitalism – a commitment to a good life for all; and a common language for assessment which the SDGs now provide.

Nicolette Loonen noted that governance for long-term value creation required integrated reporting, both internally within the firm and externally for society. Therefore, new metrics for firm management are needed. The recording of non-financial data needs to be assigned. Such data will illuminate the risk-exposure climate affecting a firm. The external value creation is what benefits most stakeholders. The non-financial metrics illuminate the "pre-financial" substructure, the use of which permits a firm to achieve profitability. The materiality of such non-financial data needs to be assessed with care and skill. To obtain more insightful metrics, a firm should institutionalize, as part of its governance, regular consultations with stakeholders.

She recommended the creation of a social council to advise boards of directors; linking incentives to long-term value creation; integrated reporting as foundational; a special committee of the board to guide transition from short-term metrics to long-term impact assessment; and composing boards with those who have insight into these new dimensions of firm governance.

It was agreed that reporting increases awareness and prevents blind spots from destabilizing firm success. Impact statements can be a lever for innovation. They can create a tipping point for improvements in firm culture and governance.

It was noted, as a caution, that too much reporting leads to excessive bureaucratic formalities getting in the way of timely decision-making and individual assumption of personal leadership in acting wisely for the firm and its stakeholders.

Adrian presented a new initiative of the Impact Economy Foundation which is to create a global community of "impact professionals" to serve as stewards of a new discipline of long-term value creation. Such a professional commitment would give an added skillset and sense of purpose to managers, owners, lawyers, accountants, scientists, NGO activists and public officials.

The CRT welcomes such an innovation in setting vision and mission for those whose daily work determines our global future.

Herman Mulder closed by summarizing the table discussions and inviting all participants to stay involved in the movement we were jointly creating.

In addition to the plenary discussions, the were many other discussions that took place. From these, the following themes and observations were reported back by the facilitators:

Transparency

Transparency was identified as a driver for change. Harmonization of methods was considered key in the short-term. In the long-term, integrating impact information in financial reporting standards, such as IFRS/GAAP and regulation, such as the EU directive, was considered key. A potential risk of impact reporting was seen in greenwashing and bias. Hence, the ability to measure impacts to a sufficient degree of objectivity was also mentioned as a key success factor.

Urgency

A question was whether businesses would feel sufficient urgency to really start steering on impact. Some feared there was not sufficient discomfort to put businesses in motion absent a new crisis. Others were more optimistic about progress made by businesses and believed the changes in societal expectations of businesses (e.g. the tax avoidance discussion) should provide sufficient rationale for businesses.

Capital Markets

A key issue was how valuing and steering on impact could be scaled up in the face of extremely competitive capital markets focusing on short-term returns. One important avenue people considered was enabling investors to be more rational and consider long-term shareholder value which is much more aligned with societal interests than short-term profit. Still, even long-term shareholder and stakeholder value can diverge in the face of externalities. Potential avenues to close the gap were pro-social investors, multi-stakeholder governance, multi-stakeholder ownership and government incentives to internalize externalities.

Ownership

Various dimensions of ownership were identified: financial, moral and control. In order to steer on impact, it may be that the current ownership model would have to change in one or more dimensions. It was noted that family businesses already have a very different dynamic than publicly listed companies.

Governance

Nicolette's proposals received wide endorsement. There were many discussions on the specifics of the proposal. Also, the risk of overregulation was identified. Still, many considered it a risk worth taking. Various participants expressed willingness to further work on these ideas.

Movement

A trend worldwide was seen of similar initiatives focused on a different form of capitalism. On the one hand, potential fragmentation was seen as a risk. On the other hand, it also provides the opportunity to create a movement with a critical mass. Several participants agreed that more companies should just start doing it. The idea to form coalitions of the willing emerged.

People

The human element was deemed crucial. Leadership should get and feel the mandate to prioritize impact and sustainability. It was noted that rarely, competences to run a sustainable business was a part of the profile when searching and hiring new CEOs. In addition, for measuring and valuing impact to influence steering and not just become a technicality, integrity and intrinsic motivation was seen as a sine qua non.

Workshop on Valuation Methodologies
Proceedings
San Francisco, California
January 7, 2020

SPONSORS: Newday Impact Investing and the Caux Round Table for Moral Capitalism

INTRODUCTORY COMMENTS

An important new development in valuation of companies is appreciation of the contribution of employees. There are 3 ways of assigning a financial value to employees: the discounted present value of their compensation, the ROI or return on that net present value or taking into consideration that companies listed on the 100 Best Firms to Work For have an alpha augmentation to their share price by 11.4% or by 6.4% on the Russell 2000 index. The Securities and Exchange Commission has called for study of valuing a firm's human capital and the International Standards Organization is working on best practice standards for assessing human capital.

George Hara was asked to provide his recommendation for looking at what creates value for companies. He noted that a company is not a singularity, but a club of associates, more like a molecule binding together different atoms to make an impact. The associates are stakeholders – customers, employees, suppliers, owners and the community. Where a company fails to invest in its associates, it fails. Where no investment is made in R&D, the company stagnates and loses market share over time. Stripping a company of cash resources to advantage shareholders similarly leads to decline, as in the business model of private equity to load a company with debt in order to provide cash to shareholders. Many notable companies pay more to shareholders than they earn: HP, Microsoft, IBM, P&G, Pfizer, Time Warner Cable and Disney.

A company's total value only increases over time when it provides benefits to all stakeholders. For mid to long-term success, investing in sustainable growth is necessary. Measuring the ROC – return to capitals – gives a higher value than the traditional ROE – return on balance sheet equity. Reformulation of balance sheets and tax statements is needed.

DISCUSSION

The current convention in valuation is to use replacement value with current costs, discounted future profits and market comparables or offers. Under current practice, it is not possible to value human capital, as accounting conventions will not qualify as a firm asset that which is not controlled by the firm. Furthermore, among the stakeholders of a firm, it is believed by many that shareholders take the most risk of firm failure, so they deserve a preferential return to lower the cost to the firm of securing financial capital. But in all cases, valuation should be a function of risk, as well as return.

Financial capital created the entrepreneurial opportunity. Financial rewards are the incentive for investment. If rewards are limited, that form of capital dries up and less risky ideas are funded.

But what is the correct timeframe for expecting returns? Mark-to-market valuations are ok for a real-time or a short-term measurement.

Pension funds need high returns for their beneficiaries. Public pension funds have a duty to seek higher returns.

Different levels of returns for different firms are acceptable, as investors can diversify across asset classes.

Yet, it was noted that metrics – sales targets, bonus compensation – affect employee behavior and so firm outcomes. Some metrics, therefore, produce better results than others.

There is a need for precision – how to allocate a total value concept among stakeholders? Also, a clearly understood vocabulary.

HP was aware of the risk to a company of losing embedded/tacit knowledge in employees that is lost when they leave the company.

Processes and methods also have value – how are they to be measured?

Rules need to be reasonable and not irrelevant in their imposition of technicalities.

The recognized ecosystem for non-profits is rather like that proposed by Mr. Hara for companies – an association of mutually supporting actors.

The goal of production is to have an impact. How should value be assigned to different impacts?

The new statement of the Business Roundtable will hold companies to a new standard of stakeholder capitalism. And a new generation of investors and employees is coming forward which is motivated by new concerns for total impacts. We need to rethink what is a good return overall and we also need to think of what happens if we don't recalculate the "good" that capitalism produces.

How are negative externalities to be associated with firm outcomes – care of the earth and climate change?

With smarter, better and more accurate metrics, we can stimulate companies to get higher returns.

Research on the return to character looking at the returns to companies depending on the quality of the leadership team shows that higher quality leadership correlates with much higher returns and lower risk.

Since companies have employment contracts with employees, they have some control over their work and productivity. An employment contract can be considered as a net operating lease, which can be a balance sheet asset.

Values/mission drive revenue, but how can you measure the impact of words? There is board complicity in firm failures. But when clarity of purpose is lost, a firm has an identity crisis and risks collapse.

Now, there is a concern for passive index funds – they lower costs to investors, but have no stewardship responsibilities.

We need to think of a continuum of firm types, from sole ownership to private companies to public companies. The roles and missions may differ from type to type. Private companies need a discount to their value, as they are not liquid.

Consequences turn on what "values" are sought to be created by a firm. Good behaviors enlarge the value pie, but other methods of valuation reward bad externalities. Valuation should reflect appropriate use of capitals by the firm. How can you direct capital to change the production and use of energy? Should it go to startup firms or to existing oil and gas companies for them to invent and deploy new technologies? How does a market get capital to where it is needed from a societal point of view?

In driving decisions, shareholders prefer the status quo; markets reward differentiation.

Smart money looks at the long-term consequences – the alpha in investment returns.

CONCLUSIONS

Participants, in general, agreed with the premise that new metrics are needed to improve the outcomes of capitalism.

They agreed that employees are a source of value.

They agreed that firm externalities provide goods and bads which need to be valued and that capitals – finance and human – need to be directed towards the good and away from the bad.

They agreed that risks and returns cannot be left out of valuation calculations.

Stephen B. Young
Global Executive Director
Caux Round Table for Moral Capitalism
Rapporteur

(Doug Heske notes)

INTRODUCTIONS

Doug Heske, Stephen B. Young, George Hara and Paul Herman led a general and opening discussion introducing the need for a more "stakeholder centric" form of capitalism driven not only by corporate governance failures, but by escalating social and environmental issues.

- An example was provided raising the question regarding where the analysis was on Boeing and its success or failures on the 737 Max aircraft and how those risks impacted stakeholder relationships

STAKEHOLDER, PUBLIC INTEREST AND MORAL CAPITALISM

Ambassador George Hara suggested that "Public Interest Capitalism (PIC) can have a significant impact on income inequality and society by improving the income of the working class and creating a society where every person leads a healthy and productive life until their last moment."

- Hara extended his analysis into consequences of shareholder only decisions emphasizing that total shareholder returns (dividends and buybacks) well exceed profits for many major companies.

- He also expressed concern that corporations who have grown in financial power and influence over the past 50 years have greater responsibility and many produce more revenue than single countries around the globe, e.g. Walmart is larger than Spain.

- Hara defined public interest as referring to the economic and general well-being of our ourselves, our children and their children.

- The purpose of PIC is to build a more robust middle class, sustain growth, support corporate improvements and entrepreneurship, encourage mid to long-term investment and to fairly distribute profits.

- While a shareholder centric spirit exists in Japan, there are no standardized metrics and will take some more time to develop such a standard.

- Hara suggested replacing Return on Equity (ROE) as a valuation metric with a new metric, Return on Company (ROC), which values more than just shareholders and where every stakeholder must benefit.

- Several global organizations have already adopted this philosophy, including Toyota, Toray, Rhoda Pharma and Mitsubishi Chemical.

- Many of these ROC companies have a much higher return than ROE companies.

PARTICIPANT REMARKS

The participants of the forum shared their perspectives, opportunities and challenges in embracing a new valuation metric.

<u>Balancing Purpose with Profit</u>

- Is it fair for investors to claim the majority of returns because they have investment capital at risk?

- Who is the public authority that will collect the return from "Earth?"

- Does the employee put anything at risk and consequently, are they entitled to a piece of that return?

- How do we then divide the profit pie up so that everyone can agree upon it?

- Those that take risk get the greatest rewards.

- Capital comes from opportunity from great rewards.

- If you limit the rewards, then you limit the availability to capital.

- Do you limit growth of innovation through an alternative valuation method?

- How do we establish rules which reasonable people can agree upon?

- What is the right time frame for corporate revenue and earnings reporting?

- What does the future of venture capital look like as a result of Uber and other companies who have not valued the stakeholders?

- Do we want investment capital to flow to companies that are not delivering a sustainable profit?

- What is a reasonable time frame to look at for delivery of a return?

- Short-termism is only a problem when people understand the true value of a company.

- What frameworks would provide greater visibility of the longer term opportunities at a company like a LT stock market?

- Should the value of a business be measured in its impact?

- Could a new metric include total addressable impact?

- Should the scope of valuation metrics be expanded to include specific impact metrics?

<u>Human Capital as a Valuation Metric</u>

- Human capital is actually valued at organizations like Duff and Phelps like other intangible assets.

- Employees are a source of value and a capital asset.

- Accounting rules are not consistent today with valuing humans like an asset.

- We must put into place a mechanism on how we start to measure and recognize the value of humans.

- How do we audit these metrics for human valuation?

- How is the concept of risk applied to human capital?

- How does ROC philosophy impact employee behavior and conduct?

- Ratcheting up goals has been a tried and true way of motivating employees to excel. How do we accomplish this and balance it with other human priorities?

- How can we drive employee behavior under this construct?

- Some organizations have not treated employee owners in the same way as external owners, e.g. Google has two classes of shares.

- The message sent is that employees shares are not as valuable as the owners/founders shares and the employee shares have no voting rights.

- A great deal of embodied knowledge came out of companies like Hewlett-Packard that wasn't necessarily attributed to a specific person or even a group of people.

- How do we approximate value attributed to the "know-how" of how to build a new product?

- How do we value human capital, social capital and tech capital?

- We need to develop a new vocabulary on how we are going to assign value to human capital.

Valuation for Non-Contributing and Extractive Business Models

- Most companies were valued higher if they were "best in class" environmentally.

- Many companies wouldn't earn a profit of they were truly expensing out all of the environmental services and extractive consequences.

- Companies today are extracting to the benefit of profits and the detriment of the environment.

- Higher set of standards for companies extractive behaviors may encourage greater activism and corporate engagement between shareholders, executives and boards.

- Accept the premise that there is some value in stakeholder engagement and participation. result.

- More demanding shareholders will engage in shareholder meetings demanding that companies walk the talk.

- Companies can no longer be these anthropomorphic organizations that are making decisions without understanding the consequences of their extractive actions.

- Customers and employees will demand a "Nothing about us without us" mentality.

- How is our world going to turn out when we don't adopt these new practices?

- The idea is to look at better, more appropriate metrics in a smarter way.

- Exon is borrowing money to pay dividends for an extractive business model.

- Companies that are extractive have higher volatility.

- Companies that invest in people, planet and trust have a higher return.

<u>Shareholder Mindsets</u>

- Some investors are saying give me impact, but don't touch my return.

- Millennials and Gen Z's are stating "Dad, your job is just to stay out of the way."

- We need more education that teaches investors that impact is here to protect returns in the long run.

- Many investors want to have their cake and eat it too and are demanding both investment and impact.

- Impact must be baked into the core of everything.

- More education needs to occur, educating both financial gatekeepers and clients on the merits of values-based investing.The younger generation wants deep, lasting and transformational change.

- If the vast majority of students were running the world, the world would be in a better place.

Executive Integrity - A Proxy for Moral Capitalism

- Demonstrate a culture of compassionate integrity.
- Executive leadership teams who embrace integrity outperformed those who didn't by 486%.
- When excessive compensation goes to CEO, it can be an indicator of underperformance.
- An important leading indicator is corporate executive team character.
- How do you vote on how CEOs are behaving?
- Outperformance is not just about CEO integrity, but about the collective team.
- What is the system that allows the human person to flourish?
- Google wants to be a values-based organization, but as they've gotten larger, the values centric mission has been harder to achieve.
- Today, they are doing what the Department of Justice says that they have to do.
- The reality is that even when organizations have good governance policies in place, they can still screw up, given the inherent conflicts within a business and balancing profit with purpose.
- Market pressures push executive teams into making decisions that reward shareholders and the business and sacrifice other stakeholders.
- Some of these market forces could corrupt a CEO with high integrity.
- How do you put values and mission up at the front so that it's a priority?
- There's a bit of a war between companies and the shareholders, shareholder primacy movement.
- A more robust stewardship model needs to be put in place.

- How do you plan value on negative versus motive externalities?
- Limit negative externalities and reward positive externalities.
- Employee engagement, productivity and the role of work.
- Employee engagement has a big impact on productivity.
- Only 20%, or one in five, employees report themselves as highly engaged.
- Build a construct where companies would form a net operating lease for the future value for the time that the employee is engaged.
- What destroys value is the employee turnover.
- Companies that have low employee turnover have high productivity.
- Poor and unvalued workplace cultures are statistically adding to incidents of depression and loneliness.
- Levels of trust in leadership are extremely low in America.
- Highest level of trust was recorded in 1974 in our government.
- The role of work in a person's life can add meaning to their life, but conversely, can extract meaning if people are not engaged in their work.
- Employee engagement is an important and lagging indicator.

<u>Country and Corporate Governance</u>

- China has adopted amazing progressive taxation and redistribution of wealth.
- Redistribution of wealth has grown an emerging and thriving middle class in China.
- Broader discussion about value and redistribution of capital is critical to bringing about a new concept of capitalism.

- The U.S. has a lot to learn from the Nordic countries.

- Enact and enforce a legal requirement to report and measure.

Models for the Future

- Huge mechanism for change that resides in the employee base given the sense of community that exists in many organizations.

- A prescription for engagement could be empowering employees to act in the role as community citizens as a part of every company.

- Employees, therefore, would feel responsible to their community.

- A high level of employee ownership can make employees feel like they've got skin in the game, a sense of common ownership, may drive a high level of employee volunteerism and low turnover.

NEXT STEPS

- Set up a team to tackle engagement with the local community.

- Develop a mechanism to take to boards and investors.

- Develop a module for board members on valuation and provide data on individual companies as a source for success.

- Start by openly advertising to board members.

- Work with a major university to provide a certificate to board members.

- Organize networking events in the San Francisco Bay Area.

- Consider getting CEOs to sign a statement that prioritizes human beings as a valuable asset.

- Draft a valuation statement as a part of corporate civic responsibilities.

- Designed to link up with one of the Sustainable Development Goals.

- Present at the World Economic Forum (Davos) on the value of human capital in 2021.

- Draft letter to major national and local publications and run an op-ed in the New York Times.

Outro

As much as anything, the proceedings from Sydney, Amsterdam and San Francisco are evidence of how, in the 25 years since we published our Principles of Business, the ideas we've been promoting, most importantly the need to create a "moral capitalism" in which success is measured not just in shareholder profits, but in the benefits produced by corporations for all shareholders, from employees, to suppliers, to customers and even the physical environment, are critical to the future of human civilization.

We, of course, take pride in the impact that this has had on enterprises around the world. At the same time, we increasingly recognize the sober responsibility we face in combating the growing threat to the very idea of productive business practices in a topsy, turvy world.

And so, we thank those who've taken moral capitalism as a model for our economic system. But there is still even more critical work that needs to be done. The hour is late and the river is rising. We either act now or consign ourselves to a future shaped by chaos rather than reason.

Richard Broderick
Director of External Relations
Caux Round Table for Moral Capitalism

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