The Grasshoppers and the Ants: Why CSR Needs Patient Capital

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Prepared
May 2006
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While many U.S. CEOs are worried about the next three months, our global competitors are making long-term investments in their companies and in their economies…We’ve created an environment where a company’s long-term value and health are all too easily sacrificed at the altar of meaningless short-term performance.

Thomas J. Donohue, President and CEO,
U.S. Chamber of Commerce, 2005

For kindred spirits, CSR champions seldom look to the Chamber of Commerce. But in the case of worrisome trends in the capital markets, the two find much in common—high anxiety over the effects of short-termism on long-term competitiveness, engineered quarterly earnings to meet analysts’ expectations and the sacrifice of long-term wealth creation in terms of human, natural and technological capital in favor of near-term profit maximization.

This paper explores why and how capital markets undermine CSR, and what is being done, and should be done, to enlarge the pool of “patient capital.” To be sure, CSR is by no means the only victim of impatient capital. A group of senior executives and trustees of large U.K. institutional investors, collectively known as the Marathon Club, recently lamented the injurious effects of market short-termism. They cite too many investment decisions based on outcomes that cannot be reliably forecast, allocation of capital to value-destroying projects to meet near-term earnings expectations and valuation of companies that fail to incorporate intangibles which are powerful drivers of long-term value. “It is not enough to secure an individual’s pension and then fail to consider our collective impact on the factors affecting the quality of that pensioner’s retirement.”

1 My sincere thanks to Steve Lydenberg, Emma Stewart and Geir Westgaard for comments on an earlier draft of this paper, and to Anna Fleder for research support.
3 Marathon Club, Long-term, Long-only Investing: A Consultation paper, London, 2006. The Club defines long-term, long-only (LTLO) investment as a “fundamental, research-oriented investment approach that incorporates the variables that explain business success and that has a focused discipline of optimising positive absolute returns over the long-term business-cycle.”
similar vein, a recent Conference Board report identifies the deleterious effect of short-termism: undue market volatility, diversion of management from achieving its strategic objectives and strengthened competitiveness and the sacrifice of worthy long-term investments in R&D and environmental performance in order to meet the pin-point earnings expectations of financial analysts. These combine to undermine confidence in the overall economy, while encouraging rewards for the few opportunists at the expense of the investor population as a whole.

From a CSR perspective, the injurious effects of short-termism are equally grave. CSR is about inter-generational stewardship of resources. It focuses on enriching the stock of human and natural capital, and creating wealth that is enduring and equitably distributed among those responsible for its creation. Juxtaposing these attributes of CSR with trends in capital markets, the misalignment between the two is serious and intensifying. The solution, we shall see, lies in a concerted effort of all market players—companies, analysts, investors, accounting bodies and the public at large—to begin moving capital markets from a mentality of trading and transaction to one of care and custodianship.

Casino Culture

The transient quality of capital markets is by no means a recent phenomenon. In the late 18th century, Adam Smith in his *Wealth of Nations* expressed concerns that passive investors and unlimited corporate scale would fail to serve the long-term interests of society as a whole. A century and a half later, Lord Keynes observed: “When the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done…” Keynes’ anxiety with the speculative inclinations of the market accompanied a period during which the bond between shareholder and company became more tenuous, more passive, and more detached. It was a period during which investors increasingly lost their sense of personal engagement with the firm as growing scale and complexity acted to disconnect capital providers from knowledge and engagement with the firms in which they invested. The notion of the corporation as a partnership of individuals organized to create wealth gave way to the perception of the corporation as property to be bought and sold like any other piece of property, without soul or sentiment.

This, of course, is exactly the direction toward which the investor-corporation evolved in the post-WWII period. The globalization of capital markets, the emergence of the modern international trade regime and the privatization of state and quasi-state enterprises opened unprecedented opportunities to purchase shares on the global securities markets. A casino-like, speculative character became more deeply entrenched even more intensely and with more profound consequences than in the depression era. Fueled by an array of ancillary forces such as executive stock options and real-time media

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reporting of minute-by-minute stock performance, the market’s speculative quality has
led to a steady decline in the mentality of trusteeship, and steady upward trends in
shifting and skimming wealth instead of creating it. John Sunderland, Chairman of
Cadbury–Schweppes and President of the Confederation of British Industries, recently
put it this way:

It may be old-fashioned but I view a shareholder as a shareholder—
someone whose interests in the success and prospects of the company last
more than three weeks…I have real concerns about promoting the use of
my company’s stock as hedge-fund plays—just as I would if they were
chips in a casino.\(^5\)

Neither the technology bust of the late 1990s nor the crash of March 2000-October
2002, in which half of the total valuation of the American corporate market
capitalization was lost, tamed these forces. Especially in the case of publicly traded
companies, the responsibilities of shareholders as custodians, boards as fiduciaries
and managers as agents of investors have been substantially undermined by the central role of
market intermediaries. To the extent that the fees of investment bankers, brokerage and
fund managers are linked to specific transactions rather than to long-term, sustainable
wealth creation, such players have little incentive to reduce volatility and, arguably, every
incentive to foster it.\(^6\) In this environment, apart from whether the share price is
anything close to a valid indicator of a company’s true current value and its prospects for
delivering wealth in the mid and long term, turnover is an intrinsic “good.”

Reinforcing all these behaviors are reporting practices and metrics that paint the illusion
of precision and “scientific” validity in company valuation. In general, over-reliance on
any single accounting measure—most commonly earnings per share (EPS)—yields a
distorted view of the firm’s financial condition and prospects, at the same time that it
fuels undue volatility in the market.\(^7\) In a recent survey of over 400 financial executives,
the majority of respondents indicated that EPS reported on a quarterly basis was the
metric of most interest to outsiders, including analysts and investors.\(^8\) Equally important,
over three-quarters of the executives indicated they would sacrifice activities with
demonstrable economic value in order to smooth earnings and meet analysts’
extpectations. Why? Because meeting this benchmark would project a firm’s capacity to
deliver consistent returns even if such returns reduced future earnings associated with
strong, value-maximizing investments.

The picture that emerges is clear: analysts’ focus on one particular indicator of the firm’s
performance, EPS, leads to management decisions that engineers earnings and drains

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\(^2\) John Bogle, The Battle for the Soul of Capitalism, Yale University Press, 2005. Bogle estimates that during 1997-2002 $1 trillion was
paid by investors to investment banking and brokerage firms, and over $275 billion to mutual fund managers.
\(^3\) Alex Berenson, The Number: How the Drive for Quarterly Earnings Corrupted Wall Street and Corporate America, Random House,
2003.
\(^4\) John R. Graham, Campbell R. Harvey and Shiva Rajgopal, “The Economic Implications of Corporate Financial Reporting,”
resources from profitable, longer-term uses of the firm’s capital in order to artificially smooth and steadily increase performance. In this way, management is beholden to the rigidities of market expectations and to the performance indicator the financial analysts have selected as superior to all others. Shortfalls relative to quarterly analysts’ expectations, reported within minutes by the business media, drive volatility as traders seek higher short-term returns to satisfy expectations they, themselves, have set.

In short, the tyranny of uni-dimensional, quarterly expectations dissuades companies from communicating the complex and nuanced realities and trade-offs that face every firm, an understanding of which is so essential to describing future prospects. All of these conditions conspire to create a fleeting, frenetic “grasshopper” quality in securities markets that, in contrast to patience exercised by ants in building community and longevity, benefits the traders rather than those who actually contribute to long-term wealth creation.

Sacrificing CSR

For companies seeking to embed CSR into core strategy, market short-termism presents a formidable barrier. In its most fundamental sense, CSR is about stewardship, trusteeship and inter-generational responsibility. Capital markets are driven by quarterly earnings expectations and, increasingly, by pressures from speculative financial instruments such as certain classes of hedge funds (in which shares of a company may be bought and sold within days). Taken together, this discourages companies from managing for the long term. Such is the case for management decisions affecting, for example, R&D expenditures, supply chain procurement practices and investments in long-term energy-efficiency improvements.

Consider these illustrative situations hypothetical, but likely to be familiar to managers facing short-term pressures.

Case 1: Mixed Messages in an Apparel Company Supply Chain

An apparel maker relies on a thousand or more contract factories for producing its branded products. The company representatives regularly audit factories for compliance with the company’s code of conduct regarding workplace standards—fair wages, non-discrimination among workers of different genders and ethnicities, no child labor and safe working conditions. CSR advocates within the firm understand that a stable supply

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9 EPS itself, like any single indicator of the firm’s performance, is a value that is subject to manipulation by managers seeking to avoid disappointing analysts with below-expected earnings. This is achieved, for example, by deferral of promising R&D projects and human capital investments, or regular maintenance of plant and equipment, at the risk of incurring future higher costs of breakdowns. Such behaviors diminish future financial prospects of the organization. Graham (note 8) found that short-termism of this nature is driven by the paramount concern of financial managers to avoid the typical overreaction of the market to missing targets; that is, reduction in share prices disproportionate to the gap between expected and actual EPS.

10 Donohue, op cit.

chain means long-term advantages in terms of reliability, punctuality and quality. The consistent message from the company to the contractor: “comply on your own, we are available to help, but expect to lose our business if you consistently fail to meet standards.” In a case of non-compliance, support in the form of financial and technical assistance, plus collaborative efforts with local NGOs, is in place to gradually correct infractions. These corrections take time. The auditors understand this and are willing to be patient rather than abruptly terminating contracts and incurring the economic uncertainties of constantly dealing with new suppliers.

Meanwhile, the procurement unit of the company signals the suppliers with an equally consistent message “faster and cheaper.” The company needs additional shipments of leading products immediately to meet quarterly earnings expectations. At times when earnings appear that they may fall short, retail outlets are urged to accept larger-than-needed shipments so the company can book revenues within the quarter, thus bolstering EPS. The contract factories feel the pressure and extend working hours, temporarily recruit child workers, gloss over workplace safety risks and defer routine maintenance in order to meet the production targets demanded by procurement staff.

The result: the contract factory survives the latest threat to its relationship with the customer, but at the cost of violating various workplace regulations, endangering child workers and increasing the probability of incurring high machinery replacement costs due to postponement of essential maintenance.

Case 2: Transforming the Business Model of a Specialty Chemicals Firm
A specialty chemical company launched a new business model aimed at transforming the company from a chemical manufacturer into a chemical service provider. Indications after 18 months demonstrate a promising business model and the management capabilities to realize its full potential. The firm has made a special effort to communicate both the underlying economics and the operational aspects of the model to chemical industry analysts and ratings organizations.

Rather than relying on bulk chemical sales to the automotive industry, the company is repositioning and rebranding itself as a provider of coating and cleaning services—a chemical management services (CMS) firm. Auto industry customers are enthusiastic since chemical procurement, storage, application and waste management heretofore have been viewed as a necessary, but unwanted, activity in the production chain. At the same time, chemical management is a diversion from the core competency of customer—the design, assembly and marketing of vehicles.

Now, the opportunity to outsource most chemical-related tasks to a CMS firm offers the multiple advantages of reduced risks associated with chemical use, the stability of fixed prices, multi-year contracts for a suite of chemical services and re-allocation of management’s time and attention to the pressing need for innovative product R&D in an increasingly competitive sales environment. In addition to these advantages, the performance contract offered by the CMS vendor guarantees reduced overall chemical
use per vehicle coated and component part cleaned. This provides the customer with the opportunity to report reduced use of hazardous materials, a benefit in terms of both regulatory burden and reputation.

From the CMS vendor’s perspective, the transformation from materials vendor to services provider is a promising but challenging one. It means a cultural shift built on profits from bulk materials sales to profits built on expertise in managing the customers’ chemical use chain. Since the unit price to coat a car or clean a part is fixed in the performance contract, reduced (rather than expanded) use of chemicals to coat and clean is the linchpin to profitability. This business model means strengthening and diversifying the human capital of the CMS vendor via retraining existing staff. In addition to R&D capabilities required to develop a steady stream of product improvements, CMS requires many additional skills to manage the customers’ chemical use chain—logistics, inventory control, high efficiency techniques for materials application, knowledge of assembly-line technologies and waste recovery and recycling technologies.

All of these skills take time to develop in a company accustomed to bulk production and sales. Equally so, the cultural transformation to a knowledge-based business encounters significant internal barriers as older employees resist change. But rich rewards are on the horizon. Among these are a major increase in the quality of human capital in the firm, stronger long-term relationships with customers large gains in the environmental performance of both vendors and customers and reduced price volatility owing to efficiency upgrades in the use of petroleum-based materials whose future is subject to price shocks and disruptions.

Unfortunately, capital markets seem largely disinterested in such promises. While the longer term is promising on virtually all fronts, transformation to a CMS business model takes time and investment in human capital. The market is impatient. Already vulnerable to reduced purchases of chemicals owing to a slowdown in automobile sales and the lower volume of coating and cleaning materials required by smaller vehicles, revenues and EPS have been at or near zero for two consecutive quarters. Impatient analysts query management on expectations for the next quarter. Meanwhile, the market is rife with talk of an acquisition by a larger chemical firm with no interest or experience in the CMS model. Pressures mount to delay or even reverse the shift to the CMS model, focus on bulk sales to strengthen next quarter’s revenues and bolster EPS through deferral of investment in new skills among managers and employees aligned with the CMS model.

Case 3: Coping with the Threat of HIV/AIDS
A multinational mining operation headquartered in the U.S. faces a rising, though still low, incidence of HIV/AIDS in its workforce in a Southeast Asian nation where it recently opened operations. The company’s experience in its African operations demonstrates the disruption and devastation HIV/AIDS can cause in both the workforce and the community: escalating rates of absenteeism and medical costs incurred by the company; high labor turnover and attendant loss of human capital in both skilled and
unskilled management and field staff; and pressures from government, civil society and unions to elevate HIV/AIDS services to the workers and communities.

Seeking to avoid replication of its African experience, the company preemptively plans to mount a costly and multi-faceted HIV/AIDS voluntary testing, education and patient care program, as well as to develop an aggressive company policy and disclosure program to protect its still fragile reputation as an extractive industry with a sizable environmental footprint in the host country. These early actions are costly, representing as much as $10 million yearly, not counting the diversion of management’s attention from core business operations that include the successful completion of Phase 1, a new mine after years of negotiation with the host government and community over revenue sharing and in–kind contributions.

Investors are watching these developments, some with an unwelcoming eye. A short memory among investors forgets the mistakes made in the company’s African operations, where years of delay in mounting an aggressive response to the pandemic, with adverse productivity and earnings effects, have come back to haunt management and, ultimately, shareholders. Now, several years after the African experience, hedge funds, mutual fund managers and some public pension fund investors do not look favorably on expenditures in Asian operations that diminish dividend payments and slow near-term growth in company earnings. For these investors, the risk of mid- and long-term escalation of HIV/AIDS in the Asian workforce and host communities does not warrant diversion of company profits from shareholders. Though the company’s overall share price has been strong owing to strong global commodity prices, ample opportunity exists for investors to shift shareholdings to extractive companies less committed to HIV/AIDS prevention and mitigation.

The dilemma facing management: scale back, defer or eliminate the HIV/AIDS initiative to satisfy investor pressure, or persevere and implement the initiative as planned to fend off a repeat of the African experience.

The common theme across our three hypothetical cases is clear: short-termism and CSR do not mesh. The situations vary widely, but the theme is constant: an apparel company striving to create humane workplace conditions in its contract factories; a chemical company transforming its business model into one that strengthens its human capital and environmental performance; a mining company grappling with the long-term HIV/AIDS risks to its workers, communities and finances. All these cases point to the incongruity between impatient investors wedded to short-term EPS and companies seeking to act with an eye toward the future. Time and again, the former prevails.

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12 Hedge funds are investment pools for wealthy individuals and institutional investors aimed at producing returns whether holdings are increasing or decreasing in share price. They may bet on exotic currency, debt, commodity and equity derivatives, as well as borrow shares in hopes of replacing them later with ones bought at lower prices. They also typically borrow funds that may take positions at levels in excess of their investors’ funds. Largely unregulated and unreported in terms of portfolio holdings, hedge funds amount to approximately $1 trillion in assets. See: http://www.pathtoinvesting.org/categories/choosinginvestments/hedge/hedgefunds_021.htm.
The essence of CSR has always been stewardship. And stewardship, by definition, is rooted in a sense of responsibility for the future well-being of individuals, communities and the environment. Thus, CSR requires managing for the long-term—the steady, communitarianism of ants as opposed to the fleeting, erratic conduct of grasshoppers.

To underscore this critical point, consider the case of successful family-controlled businesses (FCB) that are largely insulated from short-term market pressures. In these cases, ownership, business and social philosophy are distinct from counterparts that are publicly-listed. They are stewards versus traders; strategic and mission-driven versus tactical and quick-results oriented; and collective conscience and shared values versus individualistic and bureaucratic. The result is that high-performing FCBs are more likely to survive and prosper over the long term. The evidence does not suggest all FCBs sheltered from short-termism through family control automatically enjoy such success. But it does suggest that those that are high performers share certain attributes: management with a long-term view; a broader definition of “returns” that includes societal returns; and a distaste for short-term cost-cutting and downsizing.

Turning the Corner?

It is a rare CSR champion within the domain of publicly held companies who does not confront the repercussions of impatient capital. When a social or environmental initiative is subject to a business case justification, the CFO may apply a high hurdle rate that reflects less the intrinsic value (and risk) of the project than the near-term pressures to meet earnings expectations. Failing to do so almost always results in share price downturn at levels well beyond the few cents shortfall between the actual and expected EPS. Choreographing financial results by deferring promising investments in energy efficiency, supply chain labor conditions or employee skills in stakeholder engagement may yield stronger quarterly returns, but they are achieved at the expense of longer-term benefits to the organization’s brand and reputation. And postponing the launch of a social reporting program to achieve short-term cost reductions may satisfy quarterly earnings guidance, but undermine the company’s efforts to elevate its transparency to the level of best practice of leading competitors.

Indeed, virtually the entire range of intangible assets—human capital, technology innovation, high-quality supplier alliances and networks, brand and reputation, environmental acumen—are among the core drivers of value creation in the contemporary corporation. These same value drivers are closely coupled with CSR performance of the firm through reinforcement, positive synergies or simply by being one and the same. Thus, as intangible assets are sacrificed to short-termism, so too is CSR, and vice versa.

Financial performance as measured, for example, by risk (e.g., debt to equity, debt to assets, liquidity) and efficiency sales per employee, working capital to sales, gross margin. Durability as measured by survival years, life expectancy, companies over 300 years old. Miller and Le Breton-Miller, pp 19-20.

What, then, are the prospects for shifting capital markets to a longer-term perspective, thereby achieving a stronger alignment with the value creation time horizons characteristic of CSR initiatives? Some signs are pointing in the wrong direction: the entrenchment of the quarterly EPS expectations, rapid growth of hedge funds that focus on wealth shuffling versus wealth creation and merger and acquisition activity that, as often as not, enriches the few through short-term share price spikes rather than elevating the long-term wealth creation potential of the new, combined entity.

The market, so it seems, is drifting farther from its role as efficiency disciplinarian and value adjudicator, toward an increasingly speculative enterprise. Bogle puts it succinctly: “The momentary precision of the price of a corporation’s stock [has come] to overwhelm the eternal verity of the intrinsic value of the corporation itself, however difficult to measure.” Insofar as trading, speculation and “a beauty contest” (as Keynes once said) increasingly characterize stock markets, CSR will come up on the losing end.

But this gloomy picture is not without relief. The deleterious effects of short-termism are becoming subject to scrutiny by an array of stakeholders whose awareness of the high economic and social costs is gradually finding its way into public discourse. Consider these illustrative developments:

**Business**
Companies, the entities that stare short-termism in the eye four times per year, are beginning to push back on quarterly earnings guidance. Among those firms are Pfizer, Citigroup, Coca-Cola, GM, Ford, Intel and Motorola.16 Meanwhile, GE, IBM and PepsiCo are exploring principles and practices that foster long-term behavior, including tying CEO compensation to longer-term “performance shares” that vest after five years, directing board attention to long-term value drivers and strategy versus short-term shareholder value and supplementing the Annual Report with a prospectus that describes the firm’s business model, human capital and management systems.17 In a most hopeful scenario, a group of two to three dozen companies spread across all major industry sectors would collectively step forward and say: “We are jointly and firmly putting financial analysts on notice that the days of quarterly earnings expectations are over, and we hereafter will focus our strategy and resource allocation decisions on the long-term.”

**Law**
One legal scholar recently observed: “A corporation or a corporate law system designed around the philosophy that ‘anything that raises share price is good’ is likely to produce a firm that cooks its books; avoids long-term projects that won’t appeal to unsophisticated investors; chases after investment fads and fancies; tries to opportunistically exploit creditors, employees, and customers; and pursues business strategies that harm its

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To be clear, this critique of share price is far from universally accepted among legal professionals. Indeed, the idea that market mechanisms operate to accurately value publicly traded companies derives from two pillars of modern corporate finance: that stock markets flawlessly transform perfect information into valuation of the company, and that any increase (or decrease) in value is translated into a change in the value of shareholder equity, the sole claimant on residual profits.

Today, recognition that market information is far from perfect, that valuation techniques are flawed owing to their exclusion of intangible assets, and that stakeholders other than investors may be rightful claimants to residual profits—all portend a softening of the shareholder-centric view of corporate law in the coming years. One further sign: debunking the view that fiduciary duties preclude consideration of non-financial information. A seminal legal report published by the UNEP Finance Initiative makes the case that inclusion of environmental, social and governance (ESG) issues in investment decisions is “clearly permissible and is arguably required in all jurisdictions.”

**Investors**

Investors, particularly institutional investors, are awakening to both opportunities and fiduciary duties in relation to long-term investing. The consequences of ignoring financial risks such as climate change, and opportunities such as fortifying the firm’s competitive position in a carbon-constrained future, are emerging on the agenda of institutional investors. The Principles of Responsible Investment developed by representatives of 20 institutional investors and recently released by the UN Global Compact and the UNEP Finance Initiative call for inclusion of ESG issues in investment analysis, ownership policies and practices and disclosure by portfolio companies. The Enhanced Analytics Initiative, a consortium of institutional investors, is allocating a minimum of five percent of their brokerage commission budgets for investment research on “extra-financial” issues and intangibles. A group of U.K. investors has formed the Marathon Club with the objective of attacking market short-termism.

Related activities are emerging in the governance and rating communities. The International Corporate Governance Network (ICGN), whose members represent institutional investors who manage $15 trillion, recently launched a Committee on Non-Financial Business Reporting to explore the role of intangibles in value creation. Rating agencies such as Standard & Poor’s, Fitch and GovernanceMetrics now market governance assessment products on the premise that good governance, a key long-term concept, drives strong financial performance.

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20 [www.unpri.org](http://www.unpri.org)
22 [www.icgn.org](http://www.icgn.org)

All these relatively young initiatives are symptomatic of growing institutional investor impatience with short-termism. Their response, albeit slow, points to rethinking the relationship they maintain with their research providers, advisors and asset managers.\textsuperscript{23}

**Accounting**

Accountants seldom speak to short-termism, much less CSR. But they do seek to continuously update tools for measuring and reporting the value of companies and, by so doing, directly affect the prospects for CSR practices by companies. Traditional accounting frameworks have impeded rather than facilitated the integration of non-financial information into value assessment, thereby excluding consideration of contemporary long-term value drivers such as intangible assets. Why? Because accounting is “transaction-centric”—that is, unless value is captured in a transaction (e.g., the purchase and sale of an asset), financial statements do not capture it. Over time, this gap has been partially filled in the U.S. and Canada by Management Decision and Analysis (MDA) which contains largely qualitative and textual information on strategy and risks “material” to the investors.

The single-mindedness of conventional financial accounting is now receiving attention, though it still lags well behind changes in how value is created in modern corporations. But some movement is discernible. A consortium of representatives of accounting societies in Canada, the U.S., Australia and South Africa has launched the New Paradigm Initiative (NPI) under the auspices of the Value Measurement and Reporting Collaborative.\textsuperscript{24} NPI seeks to classify and compare some 80 approaches to performance and value measurement that have emerged in recent years. The Canadian Institute of Chartered Accountants itself has been a leader for a number of years in expanding the definition and reach of MDA to incorporate non-traditional information into financial statements. The International Accounting Standards Board (IASB), charged with harmonizing international financial reporting standards, has issued a discussion paper that opens the debate on how “management commentary” (MC—the U.K. counterpart to MD&A) fits into the emerging international standards IASB will promulgate in the coming years.\textsuperscript{25} In the U.K., years of work by a series of special commissions culminated in an Operating and Financial Review (OFR) framework that suggested the inclusion of material environmental and social information in company financial reports.

These initiatives are noteworthy, gradually shifting the frontier of financial reporting to encompass intangibles, CSR-related information and new concepts of risk and opportunity. All are essential to move beyond historical accounts based on transactions to forward-looking accounts based on new drivers of long-term value. While there is reason for optimism, the history of such innovation in the accounting community is one of fleeting commitment and easy diversion away from next generation accounting to


fixing shortcomings in the current framework. Accounting for stock options, pensions and derivatives attracts far more attention than do challenges to the core accounting structure within which such issues reside. Thus, the question is not whether the current wave of accounting initiatives is moving in the right direction but, instead, whether they are durable and ultimately contribute to moving the accounting mindset toward long-term value creation, measurement and reporting.

**Civil Society**

For at least two decades, civil society organizations have been active in promoting corporate disclosure of non-financial information. Such initiatives have been motivated by citizen “right-to-know” and accountability, while linkages to questions of short-termism in markets have been largely indirect or absent.

This is changing. Perhaps the most powerful evidence is the work of CERES in advancing carbon disclosure under the auspices of the Investor Network on Climate Risk (INCR). INCR works with large institutional investors, especially public pension funds, to elevate climate risk on the agenda of portfolio companies. Companies are encouraged to address material climate-related risks and opportunities embedded in sectors such as insurance, energy, real estate and others vulnerable to climate change. By identifying, measuring and reporting climate risks across all sectors, INCR focuses both investor and manager attention on one of the most urgent long-term issues that will affect business prosperity in the coming decades.

Other civil society actions of a similar nature are noteworthy. The draft “G3” 2006 Sustainability Reporting Guidelines of the Global Reporting Initiative include new material on long-term strategy, risk and opportunities associated with the environmental, social and economic aspects of business. The Extractive Industries Transparency Initiative (EITI), a collaborative among government, business, international organizations, investors and civil society, seeks to strengthen governance in resource-rich developing countries through public disclosure of payments to governments on the part of the private sector. This transparency mechanism can have the effect of mitigating investment risk in extractive activities—invariably very costly and long-term in nature—by avoiding the probabilities of instability and conflict in host countries. Like the CERES and GRI programs, EITI contributes to building the “soft law” through voluntary initiatives that can help transition capital markets toward a longer time horizon in risk assessment and investment decision-making.

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27 [www.globalreporting.org](http://www.globalreporting.org)
Prognosis

John Bogle, Founder and former CEO of Vanguard Mutual Funds, recently observed that in the U.S., society has come “to measure the wrong bottom line; form over substance, prestige over virtue, money over achievement, charisma over character, the ephemeral over the enduring, even mammon over God.”

Impatient capital markets are a leading example of this critique. The shift in the last decade toward short-termism has created, and is reinforced by a powerful class of intermediaries, new investment instruments and advanced trading technologies that have helped to fundamentally alter what it means to be a capital investor. Shareholding has been replaced by share renting. Notwithstanding the likes of Warren Buffet and other long-term investors, trading has replaced trusteeship as the underpinning of the markets. Even for those entrusted to look after the long-term interests of beneficiaries such as asset managers and trustees of pension funds, short-termism remains a serious problem.

CSR is one among the losers of these market trends. CSR is about nurturing human, natural and organizational capital such that future generations are left with stocks at least as plentiful and healthy as they inherit from the prior generation. Each of these forms of capital requires a stewardship mindset, behaving in a way that incorporates the long view. Patient capital, invested in the well-being of companies to enable long-term wealth creation, is a prerequisite to such stewardship. When investments are reduced to short-term holdings and value is reduced to an elegant—and misleading—single metric such as EPS, the conditions are in place to undermine rather than advance CSR practices.

Responsibility for this state of affairs is shared by many—financial analysts, investment banks, brokers, pension fund trustees and conventional accounting frameworks and many others. Solutions are equally dispersed: restructuring incentives to executives to foster long-term thinking, education of pensioners and their trustees, capital gains taxes that encourage wise, research-based stockholding instead of stock speculation and civil society action by both standards setters as well as campaign groups that elevate the visibility of short-termism on the environmental and social agenda.

For CSR champions, this is a process that will take time and persistence. But as our three hypothetical cases illustrate, it is a process that is indispensable to CSR’s long-term vitality. The market’s readiness to invest in environmental, human and organizational capital is in woefully short supply relative to the rising pressures on companies to help solve urgent social and environmental problems. The collective force of multiple constituencies needs to be organized and deployed against those who prefer continuation of the casino quality that characterizes contemporary capital markets.

In gambling, the house always wins unless the rules are changed. In capital markets, the house—i.e., all those players who collectively research, advise and manage investments—

29 Bogle, op cit.
will continue to win at the expense of long-term wealth creation unless the rules are changed. This is the pathway to shifting to a market ecology that favors the ants while reigning in the grasshoppers to advance the sustainability agenda.

About Allen White
Allen White in his Senior Advisory capacity with Business for Social Responsibility (BSR) has been charged with challenging both BSR and businesses engaged in the work of corporate social responsibility to think in new and different ways. In practice this has meant drafting a series of thought provoking public white papers and business briefs designed to serve as the catalyst for dialogue among the many stakeholders that affect, and are affected by the nature of business and society relations.