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Executive Summary

The environment in which today's businesses operate has undergone a fundamental transformation in the last two decades. Increasingly, leaders in the private sector have realized that old conceptions of business's roles and responsibilities are inadequate and that they can no longer afford to focus exclusively on maximizing short-term returns. The famous dictum of economist Milton Friedman – "the business of business is business" – still looms large in the minds of many executives and policymakers; nonetheless, the need to reframe the timeline, social contexts, and risk factors that affect businesses' operating environment has become increasingly apparent. Business has a license to operate granted by citizens through their governments, and that license will be at risk unless a new conception is defined in order to arm business leaders with the mandate and understandings of duties necessary for the 21st century.

Business has been, and should remain, a driver of innovation and efficiency, a creator of wealth, and a harbinger of economic freedom. As the World Economic Forum's Global Agenda Council on the Role of Business, we offer the following conception of the role of business in today's world, as well as the principles that can help businesses succeed in meeting this challenge.

The **challenge for business** *is to increase value for its stakeholders, while safeguarding the societal ecosystems in which it operates.*

Core Principles

Build broader value-creation considerations into corporate missions, strategy and operations, from measurement and accountability, as well as the induction of employees and promotion of senior management.

- Recognize and reward shareholders who hold shares longer through traditional financial mechanisms.
- Compensate executives in ways that reward long-term value creation.
- Empower boards of directors with a specific mandate of fiduciary duty, which ensures that value creation includes the broader stakeholder community, and that the social and ecological impacts of the company's activities are part of its governance responsibilities.
- Incorporate social, environmental and other such metrics into corporate accounting, balance sheets and market disclosures.
- There need not be calculative trade-offs between what is socially desirable and what is economically sound for a corporation.
- Create the incentives to ensure that institutional investors support long-term economic and social value-creation.

These principles form the bedrock of the following whitepaper, which proceeds in the following manner: Part I: Business' Challenge diagnoses the challenges currently facing the private sector. Part II: Incentivizing Responsible Behaviour identifies ways to promote better conduct from businesses. Finally, Part III: Alternative Course of Action offers specific proposals – from changing tax structures to adopting integrated reporting standards – that encourage businesses to focus on long-term value creation and acting as a force of good for the ecosystems in which they operate.

Part I: Business's Challenge[1]

The fundamental role of business has remained relatively constant throughout history and across geographies: businesses provide the goods and services that people need or want. The expectations placed on business, by contrast, have changed dramatically in the last two decades. Demographic and macroeconomic shifts, globalization, and new technologies, among other factors, have given rise to an era in which annual revenues of the world's largest multinational corporations exceed the GDPs of many countries, and half of the ten largest companies in the world are headquartered outside Europe and the United States. These changes have not only helped generate larger, more global businesses, but they have also fundamentally altered the role that business is expected to play in societies around the world.

Two decades ago, several different conceptions of business ownership dominated relatively distinct geographic contexts. In the traditional "Anglo" model, corporations were owned by and accountable to a large cohort of individual shareholders expecting reliable and increasing returns. Such businesses typically hired employees for extended time periods, socialized them to company values, promoted from within, and attempted to balance the interest of the relevant stakeholders with claims on the corporation. This model—in which owners consisted of broadly distributed shareholders who focused on mid to long-term returns—became the norm in the U.S. In the classically European business context, the private sector has operated hand in hand with government-owned enterprises and has typically taken a longer-term view of its mission than simply focusing on quarterly returns. And in many Asian and Middle Eastern business contexts, families and government interests have dominated business ownership structures. Decision-making within these entities has been influenced by family dynamics, the desire to safeguard long-term legacies, and political goals.

In today's world of globalized markets, different conceptions of business intersect, overlap, and incentivize different courses of action. This international marketplace requires businesses to be held to a set of more complex standards and answer to new constituencies, such as regulatory agencies, NGOs, activists, and emerging-market communities. The long-term success of a business depends on its ability to create value for its many stakeholders in the future, and this goal requires more than simply entering new markets and expanding its consumer base. Instead, it requires business leaders to evaluate future needs, opportunities, and risks within diverse contexts and plan long-term strategy accordingly. New technologies allow information to travel farther and more efficiently, which creates new opportunities for business, as well as vulnerabilities and risks to reputation. In addition, new actors, investing structures, and economic conditions pressure publicly-traded corporations to demonstrate short-term gains or suffer short-term loss of economic valuation in the markets. In today's financial markets, such businesses are seen less as repositories for long-term investments held by "investors" and more as a collection of assets that can be bought and sold by "traders." The combination of financial players and the increasing global presence of broadly held shareholder ownership over the last decades—typically at the expense of family-owned, state-owned, or cooperative structures—is often felt to lead to more short term focus.

Even though the ecosystems in which the private sector operates have been fundamentally transformed, many businesses remain entrenched in narrow conceptions of their core mission—whether that mission is to deliver profits to shareholders or advance government, societal, or family interests. A fundamental reevaluation of the challenges for business is required in order for the private sector to regain public trust, maximize future value creation, and safeguard its license to operate in today's interdependent landscape.

[1] The views expressed here emerged from the Council meetings and do not necessarily reflect the views of the World Economic Forum or those of all the Council Members.

New Conditions and Direct Challenges

Business's license to operate is not an inherent right; instead, corporations are allowed to exist so long as the communities in which they provide goods and services allow them to continue doing so. The ecosystems in which today's businesses operate are not only more complex environmentally, socially, and politically, but they are also interconnected due to technology and greater global trade, among other factors. The net result for business is that it can access a wider platform for innovation, but also it can be held accountable for harms caused under a broader set of circumstances. As a series of recent corporate collapses and national takeovers has shown, governments are increasingly willing to intervene and modify businesses' license based on past failure, the potential for failure, or the perception of failure. Safeguarding its license in the future, as well as discovering new opportunities for value creation requires an examination of the new conditions for and direct challenges to private-sector enterprises.

First, **public trust** of business has been tremendously eroded in recent years. In developed markets, increasing percentages of the population see corporations as self-interested profit generators that care little about their effect on society or the environment. This negative impression has been exacerbated by the recent financial crisis, even though the most significant disruptions in markets were prompted by the financial industry. Nonetheless, the loss of wealth that took place has been perceived as a failure of business writ large that comes on the heels of a series of additional failures—caused by or accelerated by business—such as climate change, financial reporting, and widening gaps between rich and poor.

In developing markets, public trust is often predicated upon a different conception of businesses as employers and contributors to society. In some cases, communities expect private companies to provide housing or education for workers' families or, more negatively, that multinationals will seek little more than to exploit a community's natural resources. As global corporations increasingly seek to enter these markets and gain credibility among new communities, they must navigate unfamiliar, often inchoate regulatory frameworks in which expectations, liabilities, and opportunities are not necessarily clear.

Not only is business faced with the challenge of rebuilding trust within developed and developing markets, the world's population is projected to grow from six billion to nine billion people over the next forty years. Businesses have increasingly recognized the challenges posed by resource scarcity, and meeting the needs of the three billion additional people will create enormous opportunities and pressures related to individual consumption and employment. Business structures must be sufficiently flexible to innovate and accommodate these new needs; meanwhile, governments have increasingly intervened to restrict or guide the way in which the private sector navigates these challenges.

Second, a number of businesses have sought to reduce their detrimental impact on the environment and act as more responsible global citizens through **corporate social responsibility (CSR)** campaigns. In the last ten years, forward-looking businesses have accepted the broader stakeholder responsibility, embraced initiatives that reduce environmental damages, and acted to promote social goods. Often in concert with organizations such as the World Business Council for Sustainable Development and the World Economic Forum, these efforts have encouraged businesses to increase transparency, conserve resources, and improve coordination with civil society and governments. The focus on responsibility has led a number of companies to build a business case for environmentally sustainable and socially constructive projects, and the net result has increased awareness about the positive role the private sector can play in society.

Despite the very positive impacts of these efforts, critics sometimes marginalize CSR campaigns as motivated by political or public relations concerns, more than by fundamental business commitments. Indeed, when these programs are housed in communications or public relations departments, their findings are rarely integrated into corporate planning and often have mixed records in reversing the overall tide of societal and governmental mistrust. When positioned as one-off activities, CSR can be seen as vulnerable when economic pressures require cutbacks. When integrated into core business strategies, however, CSR programs can have a long-term, meaningful impact on their communities.

Third, the operational ecosystem of business has been transformed by changes in **financial markets**. Starting in the 1980s, regulatory shifts in developed markets enabled financial entities to generate tremendous profits—and huge returns for pension funds and other investors—from short-term speculation. These financial structures exerted pressure on businesses to generate greater revenues every quarter, regardless of market conditions, or face extreme market devaluation. Similarly, shareholder activism has exerted new pressures on CEOs to respond to investor concerns, regardless of whether those investors have the long-term interests of the company in mind. The result has left many CEOs with the sense that increasing revenues is enough of a challenge and that any added social duty is an extraneous, even luxurious, worry.

These pressures have emerged based largely on investors' assessments of financial reporting metrics. These metrics provide effective benchmarks of financial performance in many categories; however, they give little attention to a broader set of business drivers, risk factors, and long-term activities that affect profitability. There have been efforts in recent years to improve non-financial reporting metrics that focus on non-financial reporting, including sustainability, environmental risks, and community impact, for example. Yet the lack of standardization and sophistication of some of these metrics offers investors few straightforward tools for assessing such efforts.

While these financial pressures have profoundly impacted publicly-traded businesses in the last twenty years, other ownership models—fully state-owned enterprises, family-owned companies, hybrid ventures, and public-private partnerships, for example—operate with a different set of incentives that drive business behavior. A full consideration of incentives created by these models could inform better policy and lead to creative and responsible partnerships.

Fourth and finally, the **increasing stake of governments in private business**—whether through direct ownership, state capitalism, or greater regulatory influence—poses a direct challenge to business' license to operate. In many Asian and Middle Eastern markets, this trend predated the financial crisis and has accelerated to an even greater degree in recent years. According to a recent report from the World Bank, China's stimulus package has disproportionately benefited state-owned enterprises, particularly in industries such as construction and infrastructure.[2] Likewise, in the United States and Europe, large stimulus packages have increased governments' influence on the market. In some cases, these governments have even taken direct ownership stakes in industries ranging from automotive to insurance. More importantly, governments have responded to the perception that businesses failed at self-regulation and have intervened, extended oversight, and implemented extensive regulations that curtail the private sector.

The state-ownership model often requires businesses to incorporate political or social goals within their core missions, and these goals can be as varied as extending loans to potential homeowners to increasing access to hydroelectric power. Backed by government funding, state-owned enterprises often have more latitude to develop strategy for longer time frames without facing pressure from financial speculators. However, this ownership model can skew the competitive landscape because governments have the ability to subsidize costs, alter regulation, and increase access to capital in ways that disproportionately benefit these entities. Further, it is often faulted for not encouraging productivity or innovation as aggressively as private ownership and open markets. This model can also entail dangers related to political corruption and intrusion based on government interests. In many ways, these developments are the most obvious threat to business's license to operate.

The acceleration of state capitalism has been noted by numerous commentators and has the potential to alter the terrain on which businesses operate in fundamental ways.[3] Hybrid models, in which governments and private businesses collaborate to fill societal needs, can also prove effective in meeting particular challenges. In order for business to respond to the new dynamics within global markets, it is necessary to reevaluate social expectations and reconsider the constructive role business can and does play. The classic, "Anglo" extreme as articulated by Milton Friedman—"the business of business is business"—and the sometimes pejorative caricature of CSR, in which business must showcase its positive social impact, fall short in terms of describing its role in today's complex, global framework.[4]

A new conception is needed.

[2] China Quarterly Update, The World Bank. June 2010. http://siteresources.worldbank.org/CHINAEXTN/Resources/318949-1268688634523/Quarterly_June_2010.pdf

[3] See, for example: Bremmer, Ian. The End Of The Free Market. Portfolio 2010.

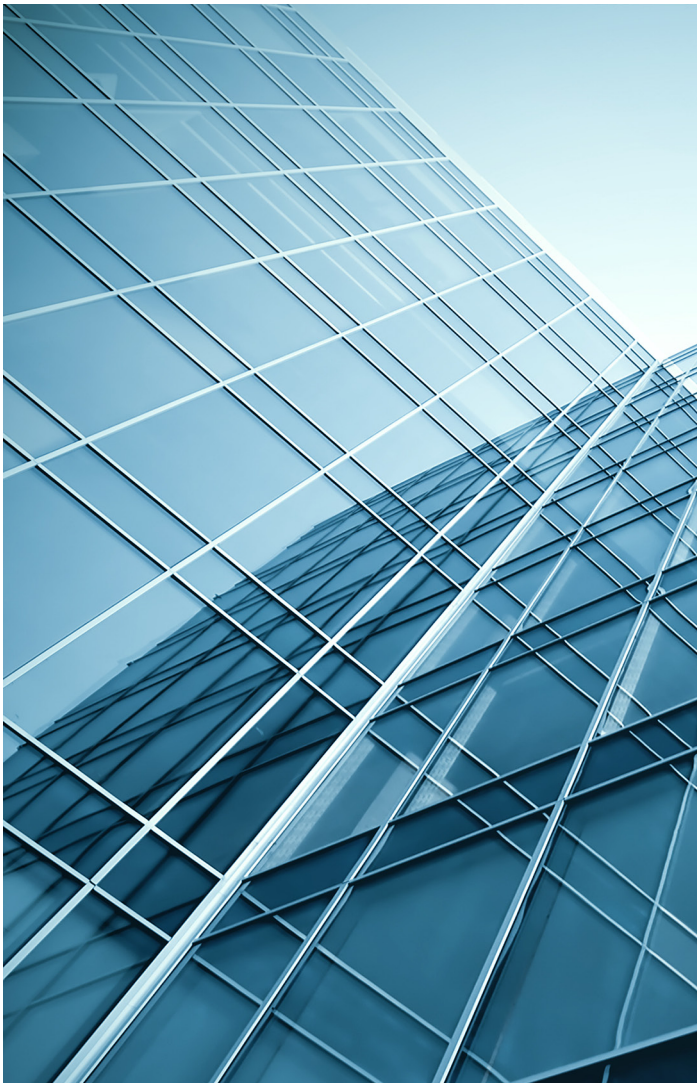
[4] Davis, Ian. "The biggest contract," The Economist. 26 May 2005.

Evaluating Social Duty

Of course, the core mission of a profit-driven enterprise is not to fulfill a philanthropic duty, but most businesses accept that their mission extends beyond simply maximizing shareholder value. Some suggest that the financial aim of corporations should be to maximize the long-term value of the company and that such maximization cannot be fully achieved without a consideration of all relevant stakeholders. History teaches the dire consequences of neglecting societal context. From sweatshop exposés to the environmental catastrophes of oil spills, many businesses have faced severe penalties for calculating their social duty too narrowly and overlooking the need to be accountable to the ecosystems in which they operate. These ecosystems constitute a wide range of factors, from environment to politics, and their health depends on a delicate balance of influences and inputs over an extended time frame. From a practical standpoint, factors within these ecosystems that are not even widely regarded "hot-button" social issues can later damage a business's reputation and bottom line, as the tobacco industry realized with lung cancer and, more recently, food companies have seen regarding obesity.1

The long-term success of a business depends on its ability to create value for decades to come, often by enhancing productivity, fostering innovation, funding research and development, and improving living standards. In order to continue creating value in this interdependent business landscape, today's companies must map strategy over a long-term horizon that accounts for new societal, political, and environmental dynamics, as well as new vulnerabilities. Publicly traded companies must use the distributed ownership model to produce distributed benefits to society. Regardless of ownership model, business is the most powerful vehicle society has to create jobs, improve livelihoods, and enhance profitability. These benefits must be distributed broadly across societal ecosystems for business to retain long-term legitimacy and prove its value through performance for both investors and this wider network of constituencies.

The challenge for business is to increase value for its stakeholders while safeguarding the societal ecosystems in which it operates.



[5] Bonini, Sheila; Mendonca, Lenny; and Oppenheim, Jeremy. "When Social Issues Become Strategic." From Business in Society: 2007 Anthology. The McKinsey Quarterly.

Part II: Incentivizing Responsible Behaviour

While defining the role of business is an important goal, the more meaningful challenge is turning this abstract notion into a concrete reality. What changes are necessary in order to ensure businesses consider a broader set of constituencies and wider impact on their societies over time? How can a business be held accountable to this mission even when financial pressures squeeze it daily to do otherwise? How can business leaders balance the short-term requirements of owners with the longer-term demands of safeguarding its license to operate?

Too often, a company that aspires to become more environmentally responsible, eliminate bribes to public officials, or offer better benefits to workers places itself at a competitive disadvantage for increased costs. However, an examination of the levers that influence corporate decision-making reveals that certain adjustments can be made to incentivize better behaviour and minimize short-term penalties for long-term responsibility.

Investors and Owners: This constituency exerts one of the most direct forms of pressure on businesses. But the strength and nature of this pressure varies greatly with the forms of ownership. Challenges that need to be addressed include:

- What reasonable, actionable, measures would help address the vulnerabilities of "short-termism" of this model in ways that comply with the legal framework and fiduciary responsibilities of boards of directors?
- What incentive structures would prompt investors, such as pensions and institutions, to act more like long-term owners rather than to focus on short-term quarterly results?
- Can behaviour be changed by the rise in transparent reporting, such as integrated reporting and measures to incorporate non-financial metrics for environmental and social impact in corporate disclosures?
- Can tax policies be altered to encourage longer-term ownership mentalities?

Different issues arise depending on the business's ownership model. Cooperatives, for example, have an almost genetic propensity to consider the social and ecological impact of their activities. The cooperative form of ownership employs well over 100 million people and, in some countries, represents up to 20% of gross domestic product. State-owned or state-controlled corporations often set politically oriented policies or strategies in place. Private companies with controlling shareholders are often immune from the pressures of short-term investors, and this can render them unresponsive to other stakeholders unless there are incentives to do so.

CEOs: Business experts by and large agree that, if a company wants to change its mission or reevaluate its impact on society, one of the most significant prerequisite is to have a committed, engaged chief executive officer. Personal dedication and consistency of messaging by this single individual have a transformative effect on the corporate culture and employees' actions. Challenges facing this group include:

- What measures can be taken to allow CEOs the flexibility and job security to make short-term sacrifices required for future gains?
- How can a culture of personal stewardship be instilled such that CEOs hold themselves accountable to the need to leave legacies more meaningful than simply increasing wealth among a limited set of owners?
- How can business schools play a role in promoting responsible mindsets among current and future business leaders?

Government: The importance of government in influencing business has been brought into sharp relief by the rise of state capitalism and the U.S. response to the financial crisis in which the government has taken ownership stakes in a range of companies. This trend toward greater governmental intervention raises questions such as:

- What issues are best suited for international regulatory entities such as the World Trade Organization, and what areas should be left to regulation by individual states?
- How can public pressure for increased oversight be aligned with the need to allow business to innovate and compete openly?
- What kind of industry agreements or self-imposed guidelines could obviate the need for government regulation?

Corporate Boards: Because they are charged with oversight responsibility and have regular access to CEOs, corporate boards represent a direct channel to refining businesses' strategic goals. Challenges for this constituency include:

- How can a culture of responsibility be promoted such that it permeates the entire business and isn't simply reconciled to public relations departments or narrow CSR report?
- Given their fiduciary responsibilities, how can boards insulate senior management from the pressures for short-term performance from some "investors"?
- What measures can board members take to improve balanced, responsible oversight in the face of new—and frequently criticized—metrics for good governance?
- What kind of leadership programs can support promotion of talent from within and long-term mindsets within a company?
- What system of executive compensation would best contribute to creating longer-term mindsets in management, as well as a sense of fairness throughout the company?

Industry: Cross-industry pressure from peers can influence business behavior and social norms. For example, the cement industry has a tremendous environmental footprint, yet its products are essential to provide housing and infrastructure in developing economies. Agreements by major players in the industry allowed private companies to pursue costly but needed measures to reduce carbon emissions, without intervention by government regulators. Questions to be addressed include:

- What measures could be taken by business consortia such as the Global Reporting Initiative, World Business Council for Sustainable Development, and World Economic Forum to increase transparency and promote new collective norms?
- Can nonbinding commitments by business federations offset the need for regulation?

Employees: Employees represent a huge constituency to which businesses must be accountable. Numerous case studies indicate that credo and culture—if espoused meaningfully and across business operations—can have a tremendous effect in terms of motivating employees to act as responsible global stewards of the corporate mission. In addition, employee retention is typically higher when workers sense that they are having a meaningful impact and that they are stakeholders in the business. How can this constituency amplify the pressure it exerts on individual employers and on entire sectors to promote change?

Consumers: This final constituency is one of the levers with potentially the greatest power to influence business and also greatest ambiguity regarding channeling this potential. While progress has been made in certain niche markets, such as energy efficient cars and organic foods, there have been few instances in which consumer demand for responsible business practices has pushed behavioral change in the private sector. How can this "lever" be better utilized in terms of consumer organizing to influence business decision-making?

Part III: Alternative Courses of Action

The following proposals represent an effort by the World Economic Forum's Global Agenda Council on the Role of Business to address stakeholder groups listed in Part II and propose action. What specific changes would improve alignment between business activity and long-term value creation across diverse ecosystems? The proposals represent the combined input from the Council as well as other sources, but each Council member does not necessarily support every initiative. Some proposals recommend sweeping, highly controversial measures; others offer cautious, incremental adjustments.

By providing this overview, the Council has delineated specific areas of focus and offered trajectories for concrete action. We present these proposals not as comprehensive list of interventions, but rather as a starting point in this call to action to solicit more ideas and to begin a shared process of changing mindsets within and about business. Among the proposals, the Council reached consensus surrounding several core themes and actions that need to be taken:

- **Strategy and Public Private Collaboration**
  - Build explicit and meaningful value considerations into the corporate strategy, mission of the company, induction of employees and promotion of senior management.
  - Incorporate specific metrics of sustainability in corporate strategies.
  - Build business leaders who are comfortable working across the private sector, government and civil society

- **Transparency**
  - Measure the full externalities of corporate operations in terms of societal impact, both short- and long-term.
  - Incorporate these externalities into balance sheets that define both financial and non-financial matters to the greatest extent possible.
  - Define new tools for monitoring, reporting and verifying a broader range of corporate information.
  - Expand the use of unified reporting strategies.

- **Governance and Compensation**
  - Provide supervisory boards with a specific mandate to ensure that companies' broader societal impacts are part of their governance oversight responsibilities.
  - Clarify and delineate responsibilities of supervisory boards to focus on long-term corporate value creation.
  - Compensate executives in ways that reward long-term value creation and broader value impact.

- **Ownership, Long-term Incentives, and Tax Policy**
  - Ensure that regulatory, tax and accounting systems encourage rather than penalize long-term investing.
  - Clarify and delineate responsibilities of supervisory boards to focus on long-term corporate value creation.
  - Increase incentives for widely-held corporations to focus on long-term, responsible goals.
  - Reward shareholders who hold their stakes in the company for extended periods of time.

These proposals, as well as a broader set of recommendations, are described in greater detail in the following sections.

Strategy

Build explicit and meaningful value considerations into corporate strategy and mission statements and present these considerations clearly and transparently to stakeholders.

Companies must take explicit and transparent actions to consider key business issues that have broader societal impacts. This consideration, built into a company's mission and strategy, will allow business to contribute solutions to the macro risks facing our society and retain its license to operate in society. Only with explicit and transparent actions to make these adjustments can business avoid relegating these issues to "public relations" considerations and instead make them central priorities.

Accelerate the integration of non-traditional financial issues into corporate strategy and operations.

The most effective way for businesses to build sustainable markets across and within countries – as well as to combat issues such as public mistrust – is to improve the integration of a broader range of factors into corporate strategy and operations. Such inclusion has been advocated by the UN Global Compact and numerous other national and sectorial consortia and initiatives, and businesses should prioritize these changes in determining strategies.

Incorporate specific metrics of sustainability in corporate strategies.

While businesses have become increasingly aware of the need to reduce environmental damage, the goal of supporting and increasing sustainability should be an integral component of corporate missions. Specific components of this goal should be:

- Reducing eco-footprints by promoting initiatives that curb energy use, emissions and waste
- Creating new products that offer environmental or societal benefits over existing alternatives
- Improving sustainability throughout corporate value chains by utilizing responsible sourcing, processes and products
- Embracing technologies and partnerships that catalyze changes among peer businesses
- Promoting inclusive business models that provide the 4 billion low-income consumers with access to sustainable products and solutions
- Focusing on "corporate social development," rather than just corporate social responsibility

Empower managers and CEOs to discuss sustainability and long-term social impact with boards and customers.

A business's strategy must emphasize the need to behave responsibly within its social and environmental ecosystems. While expressing this goal in mission statements is important, it is also essential that corporate leaders educate their boards, shareholders, and customers about these values. Business leaders must build awareness and instill the value of social stewardship throughout their companies – for boards, employees, customers and peers.

Articulate and enforce consistently high legal and ethical standards by all executives and corporations.

Although nearly all businesses profess high legal and ethical standards, the exception rate is too high. The private sector must find a way to both raise expectations and ensure that companies comply with these standards.

Investors

Emphasize the Principles for Responsible Investing (PRI) in capital allocation decisions and in conversations with businesses.

The values and guidelines asserted in the PRI emphasize a range of environmental, social and governance issues to promote responsible, sustainable behavior among businesses. Over 800 financial institutions have committed to these investing guidelines, and these and other stakeholders must deepen dialogue with businesses to apply performance benchmarks as a guide for investment analysis and decision making.

Restrict institutional investors from allocating assets to certain alternative strategies, and institute limits on fund manager compensation.

The financial chaos of the last several years was driven, in part, by institutional investors – pension, mutual and endowment funds in particular – allocating large portions of their portfolios toward non-traditional, risky financing strategies. Restricting such investing would minimize destructive "short-termism" that has been propagated by some alternative investments. In addition, public pension funds should not be allowed to hire fund manager who demand more than a transparent and agreed-upon percentage in fixed and variable compensation.

Prohibit pension funds from lending shares of their portfolios for short-selling purposes.

Pension funds and other institutional investors have contributed to the perverse economic system that evolved over the last twenty years in which the quest for short-term performance – to "beats the indices" or the performance of peers – has exacerbated negative trends and dysfunctions. By refusing to lend their shares to short sellers, pension funds would be depriving themselves of significant income; however, this restriction would curtail the problem of "empty voting." In addition, this withdrawal would reduce the supply of shares in circulation, thereby increasing the "rent" that short sellers will have to pay. Short-selling activities would be less profitable, which would reduce disruptive effects on markets and particular companies.

Review public pension funds' role as investors.

Given the large role they play in financial markets, as well as their social duty, public pension funds should re-examine their role as investors. This reassessment should focus on their policies regarding their contributions to firms' capital needs, the length of time for holding shares, their support of different business ownership models and their expectations of publicly traded companies. The results of this reassessment should be made transparent to the stakeholders of the public pension funds.

Public-Private Partnerships and Collaboration

Build business leaders who are comfortable working across the private sector, government and civil society.

Given the importance of fostering public-private partnerships, CEOs and senior management must increase interactions with a range of stakeholders – the private sector, government and civil society in particular. This ability must become a core competency of business leaders.

Coordinate investments by governments, development banks, international foundations and NGOs to support early-stage social and environmental innovation.

Greater support is needed to promote research and development as well as early-stage business innovation directed toward social and environmental goals. A coordinated effort among public-sector investors, such as governments and development banks, as well as foundations and NGOs could help incubate these efforts. An investment mechanism could be encouraged and organized centrally, by an entity such as the World Economic Forum. Funding efforts would be directed toward developing new infrastructure, reducing negative environmental impact of existing industrial plants, creating distribution channels for products with a positive social impact for under-served communities and other such efforts.

Create a set of national competitions to award responsible performance among businesses.

In collaboration with governments, a set of national competitions could be initiated to reward leadership and performance. These awards would be akin to the Deming Prize, which honors companies that have improved the development of quality control and management in Japan, or the Malcolm Baldrige National Quality Award in the U.S.

Offer "certified director" credentials from specialized schools for boards of directors.

Together, business schools and regulators of financial systems could create specialized institutes or training programs to prepare boards of directors for their responsibilities. These programs would help increase awareness about the importance of non-financial performance evaluation metrics and would address the widespread call to improve corporate governance. Further, board members would have access to a forum in which to reconceive of their traditional roles and responsibilities.

Design competitions to improve the business case for "corporate social innovation."

A series of business contests, instituted world-wide, could allow student or corporate teams the opportunity to design business initiatives that deliver positive and sustainable social and environmental impacts. Though a number of companies provide exemplary models of such behavior, skepticism persists about whether profit-minded companies can balance the financial demands of their shareholders with their responsibilities to other stakeholders. Such a competition would raise awareness about the business case of such efforts.

Increase the range of public-private partnership models.

The biggest problems facing today's world – from climate change to income disparities – are far more complex than any single company or organization can tackle. Instead, a range of stakeholders must design new public-private partnerships that harness complementary competencies to address these challenges. Such partnerships can build on the private sector's innovation capabilities, knowledge of products, networks and funds, as well as the public sector's decision-making structures, social goals and understanding of the needs of certain constituencies.

Transparency

Expand the use of unified reporting strategies.

In their book *One Report: Integrated Reporting for a Sustainable Strategy,* authors Robert Eccles and Michael Krzus argue that companies should use a "single report that combines financial and metric based non financial information" in order to unite annual reporting data and non-financial considerations within the same publication.[6] Such a strategy would prevent disclosures regarding environmental, social and governance issues from being confined to corporate social responsibility or sustainability reports.

Eccles and Krzus also argue that the Internet enables "integrated reporting in ways that cannot be done on paper," such as interactive formats that allow users to customize their analysis of financial and non-financial information. Such unified reporting strategies do not preclude other forms of information disclosures; instead, this effort centralizes data in order to increase transparency of performance that affects a range of stakeholders.

Measure the full externalities of corporate operations in terms of societal impact, both short- and long-term, and incorporate these factors into balance sheets.

A range of "score cards" for business and reporting metrics have been developed to highlight factors related to long-term social and environmental sustainability. These metrics must be standardized, and common measurements must be created to evaluate products' environmental and social footprints.

Improve energy efficiency and lower carbon emissions within the industrial and manufacturing sectors, and increase transparency about these efforts.

Rising population levels and increasing economic growth in the coming decades will drive greater energy consumption by the industrial and manufacturing sectors in particular. Businesses need to acknowledge these developments and offset environmental implications by developing smarter, more sustainable practices. Progress toward these goals should be reported transparently in businesses' annual reports.[7]

Increase usage of low-carbon technology in the transportation and mobility sectors.

World transportation activity – including shipping and aviation – is expected to more than double by 2050. These increases will not allow the industry to be sustainable if present energy consumption levels persist. The adoption of low-carbon technology – including hydrogen fuel, hybrid power, nuclear energy and biofuels – is essential. Sector-wide progress and progress within specific companies must be made more transparent through annual reporting and other mechanisms.[8]

[6] Eccles, Robert and Krzus, Michael. One Report: Integrated Reporting for a Sustainable Strategy. Wiley 2010.

[7] Concept based on "Pathways to Energy & Climate Change 2050," published by the World Business Council on Sustainable Development. Included with permission of the WBCSD.

[8] Concept based on "Pathways to Energy & Climate Change 2050", published by the World Business Council on Sustainable Development. Included with permission of the WBCSD.

Governance

Provide boards of directors with a specific mandate to ensure that the broader social impact of the company is part of its governance oversight responsibilities.

Only through explicit mandate will supervisory boards consistently understand their responsibility to provide oversight of both strategy and operations within the context of broader societal implications.

Ensure that boards of directors take particular responsibility for "frontier risks," and evaluate risks on wider consideration of stakeholder mapping.

"Frontier risks" include those issues where a company's actions could have a broad systemic impact on society, both positive and negative. Increasingly, these issues can come from new constituencies and arise in unforeseen areas. To widen businesses' perspective from limited considerations of shareholder interests to broader, more balanced "stakeholder value" models, businesses must engage in a more expansive consideration of their constituents.

Shareholders, customers, suppliers, present and future members of their communities, civil society, governments and academia – these different interest groups represent some of the stakeholders that businesses must take into account. Greater attention in identifying these groups and considering the way they fit into risk and opportunity evaluations would give businesses a more balanced approach to decision-making and identifying frontier risks.

Reevaluate governance and remuneration of management along a number of axes.

Governance structures and management compensation strategies must be recalibrated in order to increase businesses' orientation to safeguarding stakeholder interests, rather than simply maximizing shareholder value. Ways in which this change could take place include:

- Increasing diversity in supervisory and managing boards
- Changing the role of supervisory board to increase attention on corporate social responsibility and development
- Including a broader set of performance targets in determining remuneration of senior management
- Creating sustainability advisory boards to help managing boards incorporate new thinking and greater recognition of diverse stakeholder interests

Clarify and delineate responsibilities of boards to focus on long-term corporate value creation.

It should be legally stipulated that the fiduciary duty of corporate boards is to maximize the long-term value of the company, rather than focus on boosting short-term shareholder value. The latter has been the mantra of many businesses for the past two decades, and refocusing on the company's long-term value would underscore that no company can survive in the long-term by alienating or harming key constituencies.

[8] Concept based on "Pathways to Energy & Climate Change 2050", published by the World Business Council on Sustainable Development. Included with permission of the WBCSD.

The New York Stock Exchange Commission recently issued a report that supports this mindset.[9] It argues that "other corporate stakeholders" – beyond simply shareholders – "have critical interests in the long-term success of the corporation, including, for example, the corporation's employees who rely on the corporation to provide jobs and wages, the corporation's customers and vendors, as well as the communities in which the corporation operates and society at large." Likewise, the Canadian legal framework is grounded in a concept of the corporation fully compatible with this recommendation. As the Canadian Business Corporation Act notes, "often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear — it is to the corporation."[10] The duties of boards of directors should be explicitly aligned with these goals.

Increase legitimacy and credibility of corporate governance by reforming election and decision-making processes.

In order to discharge responsibilities credibly and effectively, boards of directors must be determined by fair and transparent processes. Nomination and election procedures must be reformed in order to ensure that the legitimacy and credibility of these boards is protected.

[9] "Report of the New York Stock Exchange Commission on Corporate Governance," September 23, 2010. http://www.nyse.com/pdfs/CCGReport.pdf.

[10] Supreme Court of Canada in BCE v. Bondholders.

Ownership & Long-Term Incentives

Reward shareholders who own shares for extend periods of time.

The actions of publicly traded companies can be skewed by shareholders whose interests are not aligned with the long-term success of the company. Companies' self-interest and the greater interests of society at large are compromised when these short-term interests are allowed to pressure companies into acting irresponsibly. Companies could minimize these pressures by imposing minimum holding periods – one year, for example – before a shareholder can exercise voting rights[11]. This buffer would incentivize longer-term ownership mentalities and encourage decision-making from those constituencies whose interests were aligned with long-term corporate success and profitability.

Ensure that regulatory, tax and accounting systems do not hamper, but rather encourage long-term investing.

These legal and institutional frameworks often drive the incentives and actions that lead to short-termism, and they should be evaluated and then structured to achieve long-term investing rather than encourage short-term trading.

Define specific objectives regarding what structures of business ownership best advance common social goals through a collaborative process among business, civil societies and governments.

The range of ownership structures – from family-run businesses to cooperatives to publicly traded corporations – each entail a range of governance challenges. Societies and governments must collaboratively determine the ownership structures needed, as well as the role the state should play in overseeing economic affairs. Such processes of deliberation safeguard both business and social interests. In general, the following principles should be observed:

- Societies and their governments should foster varied forms of business ownership.
- Governments should establish fiscal and legal contexts that foster alternative forms of business with more varied ownership models, including business cooperatives, employees-ownership, and family-ownership.
- Governments should promote state-of-the-art governance principles and processes for all business ownership models.

Increase incentives for widely-held corporations to focus on long-term, responsible goals.

Exchange-traded corporations typically face a great deal of public scrutiny, which increases transparency, and they are responsive to pressure from institutional shareholders and other interest groups. These companies are often proactive in initiating programs that exceed their legal obligations in order to promote good corporate citizenship. Greater incentives should be created to encourage exchange-traded and other widely-held companies to increase responsiveness and responsible behavior, and several options for improving the attractiveness of such actions include:

- Rewarding "loyal" shareholders
- Broadening and clarifying the responsibilities of boards of directors
- Reforming compensation strategies

[11] Proposal is adapted from the policy paper of the Institute for governance of public and private organizations "Corporate citizenship and the right to vote", November, 2006 (www.igopp.org)

Implement excise taxes or small fees to discourage excessive trading and encourage longer-term ownership.

A small fee levied on stock transactions would reduce the churn of shares and eliminate many of the advantages seized by high-speed trading activity. Because these transactions rarely focus on balanced corporate goals or the need to produce long-term social value, minimal fees would reduce some of their disruptive impact on corporate decision-making. Such proposals would have to be examined against legal and regulatory regimes, of course, but could be adopted with a general goal of reducing the impact of speculators.

Offer other rights and privileges for owners who hold shares for extended time periods.

Programs such as acquiring the right to vote after, say, a one-year holding period, increasing the rate of dividends after a minimum holding period would encourage shareholders to keep stocks for extended periods of time. These programs would also produce greater alignment between long-term corporate value creation and financial incentives of owners. Such policies would reduce incentives for "short-termism" and some of the reckless behaviors and environmental costs that are generated by such mindsets.

Compensation

Compensate executives in ways that reward long-term value creation and focus on broader value impact.

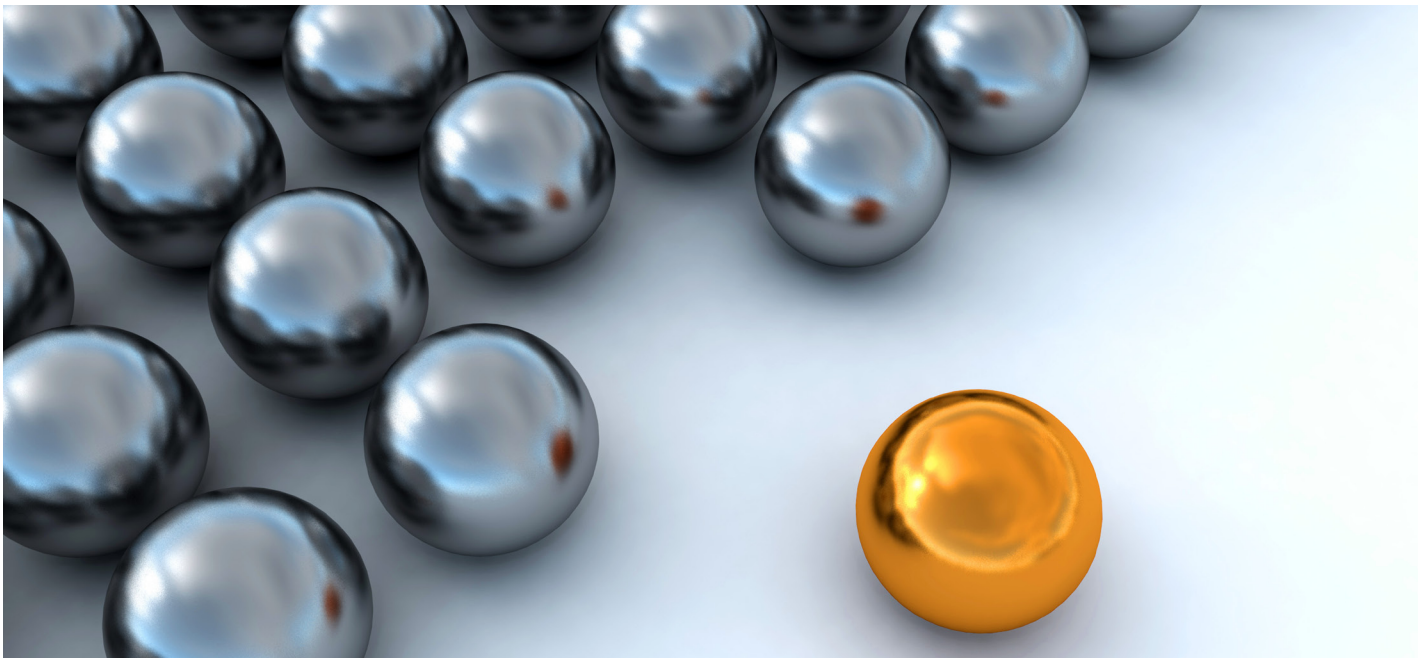
Compensation drives behavior. If long-term and broader value creation is the objective, remuneration strategies should be dominated by this objective.

Evaluate and adjust the tax treatment for different compensation programs in order to encourage long-term equity ownership and level the playing field among various alternatives.

Depending on jurisdictions, the tax benefits granted to certain compensation programs – including stock option programs – create preferences that are not always aligned to long-term equity ownership. This reform would encourage a more balanced and connected approach to corporate compensation. These calculations should be linked to quantitative and qualitative indicators of the company's economic performance that increase long-term value and enable long-term equity ownership by executive management.

Boards should connect overall executive compensation to long-term value creation, driven by appropriate metrics and references, consider the possibility of providing a cap on the ratio of the CEO's total compensation to that of the median earnings within the institution while providing robust disclosure regarding the positioning of CEO compensation relative to employee earnings.

Boards of directors of publicly listed companies should connect CEO and executive compensation to agreed-upon and transparent metrics and references that create long-term value. Robust disclosure regarding the ratio of CEO compensation to median employee earnings should be provided, which would allow the market to make its own judgments as to the appropriate levels of compensation.



Tax Policy

Revise capital gains tax provisions in order to encourage longer-term ownership of shares.

Legislation should be enacted by governments to calibrate tax rates to provide benefits for long-term gains. Such legislation could provide for phased – or "tapered" – relief depending on how long a taxpayer holds an investment. Consideration should also be given to extending the same rate schedule to dividends as a means of encouraging long-term ownership of dividend-paying shares.[12]

Remove limitations on any existing capital-loss deductibility for very long term holdings.

Many governments have enacted rules that impose limitations on the use of capital or investment losses. These rules may serve legitimate, revenue-generating tax purpose, but they can create perverse incentives in favor of short-termism. These policies create incentives for taxpayers to "harvest" capital losses in years when they have capital gains and to sell loss shares before year-end, regardless of long-term value considerations. Ending these policies would increase incentives for investors to become long-term owners and reduce "short-termist" pressures.[13]

Encourage longer-term holding by NGO or tax-exempt investors.

A large portion of investments are held in tax-advantaged accounts by either NGOs, pension funds or other tax-exempt investors. Consideration should be given to structuring policies that encourage longer-term holding by tax-exempt investors. One option is to add a small tax on the net investment income and to grant reductions or even eliminations if holdings are held for extended time periods.[14]

[12] Proposal is adapted from the Aspen Institute draft proposal "Using Tax Law to Combat Short-Termism" (November 2010). Permission granted by the Aspen Institute for inclusion.

[13] Proposal is adapted from the Aspen Institute draft proposal "Using Tax Law to Combat Short-Termism" (November 2010). Permission granted by the Aspen Institute for inclusion.

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Related World Economic Forum Projects

Develop practical ideas to place sustainability at the heart of business models.

The Forum's Driving Sustainable Consumption initiative is a multi-year project that brings together leaders in sustainability and provides opportunities to share experiences and good practices. It strives to help leaders position themselves for long-term success by rethinking growth strategies, product lifecycles and value chains to embrace the principles of sustainable consumption. Project partners are engaged in:

- Promoting a vision for a sustainable tomorrow to guide long-term business strategies
- Improving understandings of systemic complexities and the interactions of stakeholders along product value chains
- Building appreciation and trust on sustainability among key stakeholders, including consumers and policymakers

Promote responsible development of minerals, particularly in underdeveloped rural areas.

In many developing countries, mining companies and national governments enter into mineral development agreements (MDAs), which are intended to lock in a long-term allocation of benefits and obligations. To date, MDAs involve many challenges: they are at times alleged to be "unfair" to other stakeholders, not transparent, and inconsistent with the ideas of sustainable development. In addition, as economic, political and social change occurs, the agreements can lose effectiveness and applicability to new realities. The Forum's Responsible Mineral Development Initiative (RMDI) aims to explore the views, priorities and concerns of key stakeholders on mineral development to seek answers on what works, what does not, where discontent and frustration most commonly arise from, and where improvements should occur. It will explore the development of a framework that addresses the range of issues related to mineral development, through a process that includes all impacted stakeholders, and delivers balanced benefits and outcomes over the life of a project.

Deepen knowledge about long-term investing strategies and collaboration possibilities.

This project aims to analyze the benefits of long-term investing, map out the universe of long-term investors, and examine the constraints they face. Research will be conducted to show the impact of long-term investors on markets and industries, and the Forum's community of institutional investors and sovereign funds will support this study to deepen knowledge on the issue.

Promote collaboration on responsible management and usage of water.

Analysis suggests the world will face a 40% global shortfall of water between forecast demand and available supply by 2030, and the Forum has engaged in a multi-year project to promote coalitions dedicated to mitigating water insecurity. The Water Initiative, now in its second phase, is focused on working in several defined areas to create a "proof of concept" and show that a public-private-expert platform can help governments design and implement a practical national water reform agenda. Work is already underway in India, Jordan and South Africa – in addition to projects in Mexico, Pakistan and other countries – to advance this goal. The project will also design a new global entity, under the leadership of the International Finance Corporation, which can support such water strategy reforms with other governments on a long-term basis. The Forum serves as an incubator to chart and launch a new piece of global architecture related to water security.

WORLD ECONOMIC FORUM

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