



THE BOSTON CONSULTING GROUP

THE BUSINESS OPPORTUNITY IN SOLVING THE WORLD'S BIG PROBLEMS

By Wendy Woods

WHAT DOES CHOCOLATE HAVE to do with addressing some of the world's greatest challenges? More than you might think.

Consider Mars Incorporated, the sixth-largest private company in the United States. While its competitors are worrying about the availability of cocoa, Mars is confident in its stable and robust supply of the crop for the long term. That's because the company partners with nonprofit agencies that certify small-scale cocoa farmers around the world. These agencies ensure that farmers get healthy crop yields and receive a premium price on their cocoa. And they ensure that human rights are upheld and the environment is protected. These partnerships are good for smallholder farming communities, good for the environment—and good for Mars, which has mitigated a key risk in its supply chain. The company's goal: a cocoa supply that is 100% certified by 2020.

Mars's approach brings to life the power of what we call total societal impact. TSI is the sum of all the ways a company influences society, our communities, and the environ-

ment through its fundamental business strategy and its core assets, capabilities, and operations. Focusing on TSI means integrating social and environmental considerations into the real work of business: supply chains, product design and manufacturing processes, and distribution channels.

Certainly, the idea of simultaneously creating profit and societal benefits is not altogether new. But the fact remains that most companies focus almost exclusively on total shareholder return. TSI can and should stand with TSR as an important driver of corporate strategy and decision making. BCG's extensive study of more than 300 companies shows how a focus on TSI is linked to enhanced corporate performance and how some leading companies are making it work. (See *Total Societal Impact: A New Lens on Strategy*, BCG report, October 2017.)

Business Needs to Step Up

The global urgency for business to play a bigger societal role is difficult to ignore. In

2011, for instance, wealthy countries gave about \$160 billion in aid to developing countries—the nations that bear the heaviest burden of problems such as poverty, hunger, climate change, and inequality. No doubt NGOs and governments did great work with that \$160 billion, helping malnourished children, teenagers who would not otherwise get any education, and families without access to clean water.

But it is not enough. Big challenges require trillions, not just billions. The Sustainable Development Goals outlined by the United Nations, for example, aim to address some of the world's most significant challenges. But there is an estimated \$2.5 trillion annual gap between what is being spent to reach the SDGs and the full investment that's required.

Corporations can play a critical role in filling that gap. In the same year that wealthy countries donated \$160 billion to developing countries, businesses invested about \$3.7 trillion in their operations in those nations.

Given the scale of the societal challenges around the world and the magnitude of the resources business has to offer, it is clear that the only way to make substantial and lasting progress on the biggest challenges is for business, both corporations and investors, to help develop solutions. For companies that approach this creatively, there is also significant opportunity: for example, the Business and Sustainable Development Commission estimates that efforts to achieve the SDGs will open up at least \$12 trillion in annual business revenue and cost savings.

It's important to note that when we talk about TSI, we mean something different from corporate philanthropy or corporate social responsibility (CSR). Such programs are important and useful; they provide a route for corporate empathy that employees and customers value. However, philanthropy and CSR programs are not, and never will be, big enough, robust enough, or durable enough to solve big global problems. They typically represent incremental

costs to the corporation. As a result, there are real limits to how much they can grow. And in a downturn, they are often the first programs to be cut.

The Financial Rewards of a Focus on TSI

In our study of how companies are improving their societal impact, and how those efforts are linked to financial performance, we looked at two important metrics for financial performance: stock market valuations and margins. And we used performance in what is commonly referred to as ESG (environmental, social, and governance) topics as a proxy for TSI. Among our findings:

- Oil and gas companies that are top performers in certain ESG areas, such as reducing their impact on biodiversity, water, and ecology and maintaining process-oriented health and safety programs, see a 19% valuation premium compared with industry peers that perform at the median in those areas. And top performers in health and safety programs enjoy a 3.4-percentage-point premium on their EBITDA margins.
- Biopharmaceutical companies that are the strongest performers in ESG areas such as promoting employee safety and preventing mistreatment of animals see a 12% premium on their valuation relative to median performers, and those that best provide expanded access to medicines have an EBITDA margin premium of 8.2 percentage points.
- For retail and business banks, leaders in ESG areas such as integrating environmental factors into credit risk analysis boast a 3% valuation premium, and those that are top performers in promoting financial inclusion see a 0.5-percentage-point premium on net income margins. These numbers may not seem very big, but in a competitive industry like banking, even small differences matter a lot.

- For consumer goods companies, the valuation premium is 11% for the strongest performers in ESG areas such as ensuring a responsible environmental footprint and conserving water. And the companies that do best in socially responsible sourcing in their supply chain have a gross margin premium of 4.8 percentage points relative to their average industry peers.

It's long been understood that fundamental financials, growth rates, and financial risks are key to company valuations. But this rigorous analysis reveals that performance in the material, industry-specific nonfinancial areas that make up TSI also affects valuations.

The bottom line: holding all other factors equal, companies that outperform in important social and environmental areas achieve higher valuations and higher margins.

While it is becoming increasingly clear that TSI and TSR are connected—and, in fact, self-reinforcing—it is understandable that companies have focused largely on TSR. For one thing, they have been, and continue to be, under a lot of pressure to deliver short-term earnings. However, the world's largest investors, the entities that have contributed to that pressure, are increasingly recognizing the importance of taking a longer-term perspective and the value of thinking in terms of TSI. In our conversations with and surveys of investors, 75% of them say they expect improved revenue and operational efficiency when companies pay attention to TSI. And many investors are incorporating the TSI lens into their own decision making. Global assets in the category of socially responsible investing hit nearly \$23 trillion in 2016. That's up \$5 trillion from two years earlier and represents more than one-quarter of total global assets under management.

Success Stories

If the win-win of financial and societal benefits seems too good to be true, take a look at some companies that are leading the way.

Consider Airbnb. The company made a bold pledge in early 2017 to arrange short-term housing for 100,000 people in need over the next five years, including refugees, disaster survivors, relief workers, and other displaced people. As part of this effort, the company doesn't charge fees to hosts when they support such individuals. In this way, Airbnb gives people an effective way to open their homes to those in dire need.

These efforts also support the company's corporate strategy, a key element of which is increasing the number of hosts and guests on its platform. Almost 50% of hosts who offer to help during disasters were not previously registered with Airbnb. If the company had been focused solely on shareholder returns, it probably would not have identified the benefits—both to society and to the company's overall growth—in helping people in crisis.

For Standard Bank, a focus on creating positive societal impact has also yielded major dividends. In South Africa, government regulations mandate that banks direct 0.2% of their profit to black-owned small and mid-size enterprises. Many banks do this simply by making donations to black-owned businesses, treating the program as mandated corporate philanthropy—essentially, a cost of doing business. But instead of making simple donations, Standard Bank invests the money into an independent trust that is used as collateral for loans to aspiring black entrepreneurs.

As a result, the bank leverages those funds, providing capital to many more entrepreneurs than a donation model ever would allow. And because the bank's return on those loans is intertwined with the success of the entrepreneurs, Standard Bank also provides borrowers with technical advice and services. This increases the odds that the bank will do well financially and the entrepreneurs will succeed, gains that will help alleviate poverty and lift up communities. That model has proved successful, prompting Standard Bank to expand this financing approach to other kinds of small and midsize businesses.

Changing the Corporate Mindset

Business leaders may feel uncomfortable trumpeting such success stories. They may fear that talking about the financial and profit potential of their societal programs will make them seem heartless or even mercenary, and will thus devalue the good they are doing.

But that thinking must change. Companies are in the business of serving customers, profitably—they must do that to survive. Our research offers proof that one of the best ways for companies to ensure their

own longevity is to find innovative, strategic, and profitable ways to solve the most challenging needs of society. When companies can tell a credible story about how they are doing that, they should broadcast it far and wide.

The big global challenges we face will not be easily solved. There's progress, but it is not fast or far reaching enough. We need corporations and investors, in partnership with NGOs and governments, to bring forward innovative strategies and capital to create *TSR and TSI*.

About the Authors

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