Reconnecting business, and investors, with society

According to Harvard Professor Michael E. Porter, tackling societal problems represents perhaps the greatest economic opportunity today for companies and investors. When companies take on social problems with a business model, scalable solutions emerge and business reconnects with society. He explains his concept of shared value in an interview.

Professor Porter, in recent years we have seen a growing disconnect between business and society, and even suggestions that we are moving away from capitalism. How do you see the role of business in society today?

Professor Porter: There has been a growing concern among the public and political leaders that business prosperity is coming at the expense of society. The trust in business and the respect for business has been declining. This comes at a time when companies are supporting more social programs and engaging in more community and corporate responsibility activities than ever. The perception that business is bad for society is ironic because business is the only institution where wealth is actually created. Society cannot prosper without healthy businesses.

We are currently at a very important moment in terms of how the public sees business, but also how business views itself and its role. And investors also are facing some of the same challenges, because there is growing pressure on investors to encourage business to pay more attention to societal issues. Investors find themselves struggling with the question of what their fiduciary duty should be when making investments with more than shareholder value in mind.

Your recent work on creating shared value focuses on redefining the role of business in society. Can you please explain the core idea? How is creating shared value (CSV) different from corporate social responsibility (CSR)?

Decades ago, the prevailing view was that the responsibility of companies was limited to running their business well and being profitable, because this was what allowed businesses to employ people, buy goods and services, invest, and pay taxes. Over time, as the problems of society have grown and become more evident, businesses have faced pressure, but also felt the need, to see their role as broader. The first step in this direction was philanthropy – setting aside resources to give back to society and providing their employees as volunteers. While corporate philanthropy has grown to become a very substantial activity, its legitimacy has been questioned: some wonder whether businesses should be giving away shareholder money or whether shareholders themselves should do so. The effectiveness of corporate philanthropy is also debated in terms of its impact on societal issues, given the fragmented giving typical of most companies.

The next stage in how companies approached social issues was Corporate Social Responsibility (CSR), focusing on compliance with good standards of ethics, transparency, and corporate citizenship, and meeting standards based on CSR indicators. CSR is a step forward because it has raised the bar in terms of corporate social impacts and transparency. CSR has helped minimize the negative impact companies may have, but again the big question is whether this approach really solves societal problems.

In my article with Mark Kramer,* we introduced the idea of creating shared value as the next major stage in the role of business in society. CSV does not replace the earlier stages, but goes well beyond them. It is based on identifying those areas in which the company is not merely reducing the harm it does and giving back, but where it can actually address the societal issues that its business affects.

The idea of shared value is that a business can have the greatest impact on societal problems by addressing them with a business model. In other words, the company employs capitalism to positively affect society, which makes its impact sustainable and scalable. Ultimately, the company's real positive impact on society will come from identifying those areas in its business where it can actually meet a very important social or human need, or operate in a way that achieves social benefits such as environmental improvements while making a profit. This represents a fundamentally different idea from CSR.

There is tremendous excitement in the corporate community about reframing the question in this way, because it allows companies to think about doing what they do best – meeting needs at a profit. Applying this idea stimulates innovation and new thinking about how to enhance products, reach new customers, operate the business in a more productive way, and improve circumstances in the communities in which the company operates. Ultimately this makes companies be more successful as businesses.

What is the role of investors in creating shared value? What are the implications for UBS and its clients?

Thinking among investors about their role in all this has evolved in parallel to corporate thinking. Over time, investors have come to be seen as one of the causes of societal issues by forcing companies to narrowly focus on short-term objectives. In an effort to counter this, socially responsible investing emerged, where investors screen companies based on corporate responsibility criteria. Socially responsible investing has been mostly about screening out companies seen as causing harm, and little association has been found between this and profitability.

The next stage, impact investing, reflected the idea that a business can have both an economic and a social purpose. Here investors focused on mostly smaller companies that generate social along with economic returns. However, there have been a limited pool of impact investing opportunities available and questions about whether investors should accept a reduced return to get the social component.

The shared value concept focuses squarely on opportunity, not tradeoffs – it is about how making a positive social impact actually benefits economic performance, not about how much economic performance investors should sacrifice to obtain the social impact.

The shared value idea is not limited to a relatively small number of social enterprises. Any company can enhance its economic performance by thinking about shared value through its products, value chain, and role in building business infrastructure in its communities. For example, in pharmaceuticals, the company Novo Nordisk is using the shared value concept to serve customers it had never served before in China and other emerging markets by developing a new business model for reaching lower income people without access to a well-developed health system. The company has been able to create a $1 billion business in China starting from zero.

Shared value investing illustrates a new way of thinking about economic performance. Rather than examining only conventional factors, shared value opens up a new set of opportunities to achieve economic success. Investors that are successful at finding companies that are good at this will achieve superior investment performance.

Shared value, then, becomes integral to all investment analysis. Opportunities to serve unmet needs and underserved customers can be incorporated into revenue growth assumptions; the positive impact from redefining productivity in the value chain can be incorporated into cost assumptions; and the positive impact from enhancing local community infrastructure affects both revenue and cost. Any company can be analyzed using the shared value investing lens.

Are there ways that UBS and other large global banks can adopt shared value thinking in their internal operations? How does shared value work within the banking industry?

Banking is a diverse set of businesses where there are ripe opportunities for creating shared value. For example, in U.S. consumer banking, and even more so in emerging markets, many customers are unbanked or underbanked. Banks can offer new kinds of products that truly meet the needs of such customers including savings, access to their funds at low cost, etc. Banks also have the opportunity to facilitate solutions to problems such as poor housing and energy efficiency. But too often banks have sold products that benefit them but work against consumers, such as free checking accounts with high overdraft fees.

Some commercial banks have embraced the shared value concept, but they are still a minority. Banks like UBS have a fundamental responsibility to be leaders in their communities or society will continue to perceive them negatively. Here is an industry that, more than almost any other, needs to internalize shared value.

In investment banking, I believe the greatest shared value is created when banks provide low cost capital to companies and other investors in real assets that create attractive returns on that capital. If investment banks can identify sound companies, validate their performance, and monitor companies closely and help them improve and grow, banks will play their fundamental role in society. As events in recent years have revealed, however, many investment banks lost their way by becoming more and more decoupled from the real economy. They focused on derivatives, hedging, hyperliquidity, and other products often far removed from real investments. Many of these products may have benefitted investors but did little to create wealth in society.

Investment banks should reorient themselves toward providing capital to the real economy and building long-term relationships with companies to help them grow and prosper. Too many corporate leaders I know say privately that banks are no longer focused on their true interests.

How do you think shared value thinking will evolve in the coming years?

I am spending a large portion of my time on this because it is essential that we find better ways to tackle all these problems of society, and restore trust in business.

My personal passion right now is not only to bring the idea of shared value to businesses, but also to the world of finance. I fear that the financial sector has become the tail that wags the dog of the real economy, in a way that the dog itself is not doing well. Banks need to guide their strategies with a fundamental question: "Is what I'm doing really benefiting people and the real economy?" Banks will only restore their reputations, and their sense of purpose, when they answer a clear yes.

Interview: Linda Mazziotta, UBS Corporate Communications

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The views and opinions expressed herein are those of Professor Porter and do not necessarily reflect those of UBS

Shared value and UBS

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Michael E. Porter

Michael E. Porter is a leading authority on competitive strategy, the competitiveness and economic development of nations, states, and regions, and the application of competitive principles to social problems such as health care, the environment, and the corporate role in society.

Professor Porter is generally recognized as the father of the modern strategy field, and has been identified in a variety of rankings and surveys as the world's most influential thinker on management and competitiveness. He is the Bishop William Lawrence University Professor, based at Harvard Business School. A University professorship is the highest professional recognition that can be awarded to a Harvard faculty member.

He is the author of 20 books and over 125 articles. He received a B.S.E. with high honors in aerospace and mechanical engineering from Princeton University in 1969. He received an M.B.A. with high distinction in 1971 from the Harvard Business School, where he was a George F. Baker Scholar, and a Ph.D. in Business Economics from Harvard University in 1973.

Professor Porter was one of the key speakers of UBS's recent Q-Series® "Inflection Points" Towards Sustainability Conference initiated by Erika Karp, Head of Global Sector Research at UBS, Investment Bank.