POSITIVE BUSINESS GROWTH & BETTER SHAREHOLDER RETURNS THROUGH SUSTAINABLE DEVELOPMENT

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ABSTRACT

The traditional principle of shareholder theory, developed by Milton Friedman, states that a business's only obligation is to maximize profits and increase shareholder value. However, this theory is now considered inapplicable in contemporary capitalist societies as corporations have a greater impact on the environment and society and need to be held accountable. Additionally, a short-term focus on maximizing shareholder profits can lead to negative public perception and penalties, which ultimately harms shareholder value. Today, corporate sustainability is seen as a positive correlation with long-term shareholder value addition. Studies have shown that companies that implement sustainable strategies have better long-term growth and attract more investments. Examples of companies that have successfully implemented sustainable strategies include Unilever and 3M, which have improved their brand value and profits through environmental and operational sustainability.

An Overview of Corporate Sustainability & the Freidman Hypothesis

Historically, corporations within capitalist societies have subscribed to the principle of *shareholder theory*. The idea was developed by Milton Freidman who stated that a business has no social obligation apart from maximizing profits and increasing shareholder value. Proponents of the shareholder theory considered any deviation from the abovementioned to be State interference and Socialist propaganda.

However, due to a shift in the architecture of the economic and political ecosystems, Friedman's theory is considered inapplicable to contemporary capitalist societies. Massive conglomerates hold sway in their respective sectors and must be held accountable for their actions that have an adverse impact on the environment and the people. Additionally, Friedman's theory fails on the juncture that a company established solely to maximise shareholder profits is only viable as a short-term option. Such a corporation would invariably disregard other considerations like worker compensation, environmental effects, and hazardous workplace safety, thereby drawing the market regulator's attention and attracting the possibility of penalties as well as negative public perception, all of which would have a depreciating effect on the share price and ultimately discourage additional shareholder investment.

Sustainable Business Development and Long-Term Shareholder Value: A Positive Correlation

In modern times, the practice of corporate sustainability has a positive correlation with long-term shareholder value addition. A 2010 study by KPMG reveals that 62% of managers in top corporates have employed a strong corporate strategy to promote sustainability. An additional 11% of the study conducted were in the process of deploying a sustainable strategy for better corporate profits. A majority of the management within the study agreed that sustainability acts as a source of innovation alongside new business opportunities. They also agreed that deploying sustainable business strategies, especially within vulnerable areas helped long-term growth, better shareholder value, and greater retailer investments. While these strategies took years to implement, the pros outweigh the cons. The best demonstration of the abovementioned practice was demonstrated by *Unilever*, the British conglomerate before the Friedman hypothesis even existed.[1]

[1] Lynch, Sheri L., "Business Case Studies in Sustainability Practices" (2016). Honours Undergraduate Theses. 100.

Lifebuoy, the soap brand was launched by *Unilever* in India by the end of the 19th Century. The product was launched alongside a campaign promoting hygiene and reducing child deaths from preventable diseases such as diarrhea. The company launched a handwashing programme in the State of Bihar and had a significant impact in reducing the number of child deaths from a staggering 36% to 5% within the region. Furthermore, it increased the brand value of both *Lifeboy* and *Unilever* and significantly increased their profit margins, therefore, increasing shareholder value and inviting more investments.[2]

It is pertinent to note that the term "sustainability" cannot be perceived exclusively through the lens of environmental considerations; rather, it can cover a variety of operational requirements for an organization such as better shareholder participation and a reduction of overhead costs. 3M, the American conglomerate understood the practice of environmental sustainability, shorter operational costs, and long-term growth. It introduced its “Pollution Prevention Pays” (the 3P) policy in the year 1975. The policy emphasized reducing input costs by creating efficient development cycles, redesigning equipment, reducing waste output, and decreasing energy consumption. The policy helped the company save up to $2.2 billion. 3M also reduced water wastage by improving inventory management and overall energy consumption saving up to $180 million per year.[3]

Sustainable and long-term oriented approaches by a business lead to output cost inputs for the consumer, leading to better consumer satisfaction and invariably, better profit margins. *Sunlight*, a water-saving dishwashing product, developed by *Unilever* showcases another business practice that helped promote sustainability and capture a significant portion of a new market. The product was launched in water-scarce markets within several African countries and became an instant success. It required less water consumption when compared to its competitors leading. The introduction of *Sunlight* also had a positive growth impact on other similar water-saving products developed by *Unilever* in similar markets.[4]

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[2] The RBC European Equity team. (2019). ESG and shareholder value. Rbcgam.com. https://global.rbcgam.com/sitefiles/live/documents/pdf/whitepapers/eue_esg-and-shareholder-value.pdf

[3] Henisz, W., Koller, T., & Nuttal, R. (2019). (rep.). Five ways that ESG creates value. McKinsy & Co. . Retrieved 2022, from https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx.

[4] Henisz, W., Koller, T., & Nuttal, R. (2019). (rep.). Five ways that ESG creates value. McKinsy & Co. . Retrieved 2022, from https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Fina

ESG Factors: A Better Screening Tool for Modern Investors

Environmental, Social, and Governance factors or ESGs help investors screen for companies for potential investments. The "Environmental" criteria consider the potential impact of a business on the environment. The "Social" criteria consider principle-agent, customer, and supplier relationships. The "Governance" Factor considers third-party audits, regulation compliance, and shareholder rights. These three factors are taken collectively into account and a business is given a score accessible to the public. In India, SEBI has made it mandatory for the top 1000 publicly listed companies to comply with ESG norms considering over 120 different metrics from April 2023. Presently, leading blue-chip businesses such as Wipro Ltd., Tata Chemicals Ltd., Godrej Consumer Products Ltd., etc. engage extensively in ESG compliance and sustainability promotion.

Corporate Social Responsibility or CSR Activities have also been made mandatory in India for publicly listed companies and since its inception, CSR spending has seen a massive increase number in various avenues such as education and healthcare. The TATA Group works at the forefront and has been responsible for kickstarting various programs and endowments for numerous institutions. However, unlike ESGs, CSR-based activities are not rated and scored by external private firms and think tanks which help give a valid and objective measure of the business in question. A higher ESG score suggests stronger internal governance and regulatory compliance thereby helping investors choose a less risky firm in the hope of better returns and therefore increasing the level of investment at the firms that comply with ESG norms.

CRISIL, a research organisation, and a think tank assessed and complied the ESG scores of a total of 586 Indian companies and placed them in five different categories. The report elucidates that nearly 80% of the companies assessed were placed in either the "adequate", "weak" or "below average category". However, the ESG scores for most firms have increased as indicated by better information disclosure and regulatory compliance.[5]

Additionally, research studies report a direct proportionate link between shareholder profits, staff retention, and fulfillment. This is because a business that complies with ESG standards would be seen as a favourable and desirable place to work and may provide its employees with

nce/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx.

[5] CRISIL. (2021). Through commitment to sustainability. https://www.crisil.com/content/dam/crisil/investors/annual-reports/2021/sustainability/sustainibility-esg-report.pdf

a feeling of purpose and belonging. Weaker ESG conformity has been linked to reduced worker confidence and weaker productivity. Additionally, adhering to these regulations indicates a good form of management by the management and the board of directors. Firms that conform to statutory and ESG norms find it easier to access newer markets and expand in already-existing ones. Additionally, governments and regulators in newer markets are more likely to grant licenses and be given subsidies to firms with good ESG scores.[6]

Through the abovementioned hypothesis, we can come to the inference that Friedman's hypothesis was erroneous. A business that complies with regulations and engages in activities that promote sustainability and improve the overall community command a better brand perception, higher market share, and more retail investments. Such businesses serve as a safe harbor for long-term value creation from the perspective of the shareholder. It is advised that businesses create/shift their business cycles and approach a more sustainable workflow with the aim to reduce energy consumption and lower input costs for better profit and business growth in the long term.

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[6] Henisz, W., Koller, T., & Nuttal, R. (2019). (rep.). Five ways that ESG creates value. McKinsy & Co. . Retrieved 2022, from https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx.