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The New Capitalism

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The New Capitalism

Steven Gliberman

Introduction

The free-market system has long been criticized for a litany of actual or imagined flaws. Indeed, writers as ideologically diverse as Karl Marx and Joseph Schumpeter have questioned capitalism's ability to survive.¹

More recently, a movement and a supporting literature has emerged that puts forward initiatives to make capitalism both more socially beneficial and more sustainable. The initiatives are meant to reorient the goals and actions of private sector managers and investors—in some cases away from profit or

wealth maximization, and in all cases toward the pursuit of larger social objectives. The call for a new set of guiding principles for private sector organizations has taken various identities over time, including socially responsible business behaviour, stakeholder capitalism, sustainable capitalism, socially responsible investing, sustainable investing and, most recently, ESG investing.² While there are differences across the varied calls for reforming capitalism, for example whether the main focus is on managers of operating companies or on wealth managers, they all call for a new form of capitalism.

In fact, an initiative called “The New Capitalism Project” was launched in February 2020 by the US National Civic League with the ambitious goal of changing the future direction of capitalism.³ The broad objectives of the New Capitalists, a group that includes many business leaders, can be summarized as follows:

Imagine a future where the economic and financial system serves everyone—a system that is accountable for its effects on people and the planet. Envision a world where financial markets serve all members of society and where finance plays a central role in solving the social and environmental challenges facing the global community such as poverty, inequality and climate change. (Global Impact Investing Network, 2022)



The purpose of this essay is to identify the arguments and recommendations of the various schools of thought that can be grouped under the heading of New Capitalists. Where appropriate, it will also note important points of disagreement. The essay will refrain from evaluating the arguments and recommendations discussed as that is the task of succeeding papers in a series of essays on capitalism and ESG, *ESG: Myths and Realities*, to be published by The Fraser Institute.

Multiple stakeholders

The preceding statement from the Global Impact Investing Network illuminates the key elements of a broad program for reforming capitalism. One element builds on the premise



that managers of most private sector organizations focus exclusively on creating benefits for shareholders and ignore the impact of their decisions on other groups in society—including consumers, employees, suppliers, and the local and global communities in which they do business. This premise underlies calls for managers to adopt a *multiple stakeholder* model in which managers of for-profit organizations prioritize the welfare of other groups in addition to the welfare of shareholders.⁴

To be sure, many proponents of a stakeholder approach to managing for-profit enterprises acknowledge that creating wealth for shareholders obliges managers to consider the welfare of others besides shareholders, particularly those who provide inputs to the managers' organization including employees and suppliers as well as the customers who buy the products the organization produces. Simply put, in competitive markets creating wealth for shareholders obliges management to strike agreements with input suppliers that are "fair" to those suppliers. The required collusion among the many organizations bidding for the inputs in question that would result in unfair terms and conditions being imposed on the suppliers of such inputs is legally prohibited and practically unsustainable. Similarly, competition among firms ensures that managers will recognize consumers as important stakeholders and that for-profit enterprises will strive to provide consumers with the competitively priced products that these consumers desire.

A more nuanced argument for stakeholder capitalism acknowledges the competitive imperative for managers to recognize the importance of other groups besides shareholders but criticizes the motives for this recognition. Specifically, it questions the morality of acknowledging the importance of input suppliers, consumers, and others whose activities can influence an organization's profitability solely as means to increase the organization's profitability. This

nuanced argument essentially criticizes a utilitarian approach to caring for stakeholders beyond just shareholders because doing so contributes to the organization's profitability.⁵

In this vein, Burton and Dunn (2005) argue on moral grounds that managers should “care” for the individuals whose lives are affected (or could be affected) by the organization's activities.⁶ In doing so, they acknowledge that managers might find themselves in situations that compel them to decide whose needs are most important. In such cases, the manager is obliged to determine whose needs will shape their decisions and then try to explain to other stakeholders why the manager decided in that particular way. However, the authors offer no concrete rules for managers to rank the relative importance of shareholder needs. Nor do they discuss the potential for “caring” organizations to go out of business because they failed to earn risk-adjusted rates of return sufficient to attract and maintain adequate levels of financial capital.

In short, the stakeholder critique of private enterprise rests on a precarious balance. On the one hand, if it is profitable for companies to prioritize the interests of individuals and groups beyond their shareholders, the practical relevance of the critique is moot, since managers will adopt the precepts of the stakeholder model while still focusing on maximizing shareholders' wealth. On the other hand, if this utilitarian approach to managing for-profit organizations is fundamentally immoral, how do managers address the inevitable conflicts between the interests of different stakeholders? Furthermore, how do managers address the tradeoff between prioritizing the needs of non-shareholders and staying in business? Certainly, a bankrupt organization is unable to provide benefits to any stakeholder group.

“How do managers address the tradeoff between prioritizing the needs of non-shareholders and staying in business? ”

Sustainability

The statement attributed to the Global Investing Impact Network cited earlier also underscores a crucial feature of most calls for a new capitalism. Namely, companies and investors should ensure that their actions address environmental and social challenges that threaten the continued existence of society and the planet. Concerns about the sustainability of the physical environment encompass the “E” in ESG investing, while concerns about the sustainability of society encompass the “S” in ESG investing.

Rull (2011) characterizes the classical notion of sustainable development as arguing for caring for the natural environment because it is the primary provider of resources to sustain human life. Others have added a social element to this by recognizing that sustainable development involves the simultaneous pursuit of economic prosperity, environmental quality, and social equity.

Schweichart (2010) argues that all economists, whether conservative, liberal, or left leaning, recognize that market transactions can create or involve externalities (costs or benefits)



that are not paid for by the transacting parties and that there is a role for governments to play in rectifying these defects. In this context, while economists debate the appropriate role for government in addressing externalities, there is nothing new about the new capitalism when it comes to recognizing the social costs of environmental externalities.⁷ What is arguably new is the admonition that companies and investors should

“internalize” the costs of environmental externalities, even when there are no laws, regulations, or other government rules to guide the behaviour of business organizations in this regard. That is to say, companies should recognize environmental externalities as part of their business strategy beyond what may be required by laws and regulations. One of the most well-known proponents of the new capitalism, former US Vice-President Al Gore, makes the somewhat ambiguous assertion that while businesses cannot be asked to do the job of governments, companies and investors ultimately must mobilize the financial, physical, and human capital required to overcome the unprecedented environmental challenges the world faces (see Gore and Blood, 2011).

In a similar manner, there is nothing new about concerns surrounding inequalities in the distributions of income and wealth. Again, what might be new is the call for private sector organizations to help remediate economic and social inequities. In 2017, the International Business Council (IBC) of the World Economic Forum sponsored *The Compact for Responsive and Responsible Leadership*. Among the Compact’s long-term objectives is to end poverty and hunger, in all their forms and dimensions, and ensure that all human beings can fulfill their potential in dignity and equality (see World Economic Forum, 2020). The IBC, along with many other proponents of a new capitalist system, argue that aligning corporate goals to the long-term goals of society—including addressing economic and social inequities—will prove profitable for those businesses that do so. If doing good for society equates to doing well financially, then championing environmental and social goals for capitalists is equivalent to advocating that businesses pursue efficiency and profit-maximization. If addressing economic and social goals is desirable but not necessarily profitable, the challenge for new capitalism is how businesses can be self-sustaining if they are expected to prioritize and direct scarce resources toward unprofitable initiatives.

Governance

The “G” in ESG stands for governance, which broadly represents the organizational and operational features of organizations. In the model of new capitalism, aligning governance with the broad objectives of remediating environmental and social problems is a way to pursue those objectives while also being profitable. Indeed, the implicit notion behind the

importance of a new form of corporate governance is that it will assist managers and investors to identify profitable opportunities that are consistent with responsible stewardship of the physical and social environments—or, at least, that it will help managers and investors mitigate risks that will inevitably arise from unresolved environmental and social problems. In this view of the world, it is not that socially responsible corporate behaviour is unprofitable. Rather, it is that meaningful changes in the governance of corporations are prerequisites to harmonizing profitability and socially responsible behaviour.

There are two major elements to improving the governance of operating companies and wealth managers who, in today's economy, are charged with allocating much of the collective savings of private investors. One is to improve the diversity of corporate board members as well as of senior executives. While social justice (part of the “S” in ESG) typically is the initial impetus behind the case for inclusion and diversity, companies are increasingly being advised to treat inclusion and diversity as a source of competitive advantage.



In this context, diversity is defined as having a greater proportion of women in the workforce and in the ranks of top management as well as having a more mixed ethnic and cultural composition of the workforce—and especially of the leadership of large corporations. Proponents of this school of thought see more diverse companies as better able to attract top talent and improve their customer orientation, employee satisfaction, and decision-making (Hunt, Yee, Prince and Dixon-Fyle, 2018).

A second broad element to improving governance is to incorporate ESG reporting into the planning and execution of the business strategies of operating and wealth management companies. “Better” ESG reporting would supposedly assist managers to identify and leverage profitable opportunities consistent with the goals of sustainability. It would also help companies identify their commitment to solving environmental and social problems which, among other things, will assist in attracting investors who are themselves committed to socially responsible investing. This, in turn, will result in lower debt and equity capital costs for companies, thereby acting as another source of competitive advantage.

Standardizing ESG disclosures

Many investment managers of ESG-themed funds argue that the financial benefits of ESG investing would increase if there was more consistency in the reporting of ESG metrics.⁸ In this regard, ESG ratings and indices prepared by rating agencies such as Sustainalytics have been widely criticized for being of inconsistent quality and often conflicting. This perspective, in turn, has led to calls for mandating disclosure of standardized ESG information

“Many investment managers of ESG-themed funds argue that the financial benefits of ESG investing would increase if there was more consistency in the reporting of ESG metrics.”

(Steffen, 2021). For example, the CEOs of eight major public pension funds in Canada recently teamed up to demand that companies adhere to the recommendations made by the Sustainability and Accounting Standards Board and the task force on climate-related financial disclosures framework when reporting ESG disclosures. Perhaps the most prominent call for standardization comes from the World Economic Forum’s International Business Council, which has proposed a set of common ESG metrics with the goal of driving a convergence of

global reporting standards—ostensibly to provide asset managers and investors with better data for investment decision-making (Gagnon, 2021).

Whether standardized ESG reporting would pass a social benefit-cost test given the diverse technologies companies use, the different markets they serve, and the differentiated output those companies produce, is highly questionable. For some companies, specific metrics related to, say, water usage might be financially material, whereas this likely would not be the case for many other companies. Nevertheless, regulators are continuing to move in the direction of mandating increased disclosure of specific ESG metrics.

The European Union (EU) has had ESG disclosure mandates for publicly-listed companies since 2018 that are explicitly tied to the EU’s policy embrace of the UN’s Sustainable Development Goals. In the United States, the Securities and Exchange Commission (SEC) has indicated that ESG disclosure regulation will be a central focus of its attention in future. In May 2022, the SEC voted to advance a proposed rule requiring public companies to make public disclosures of risks to physical assets from climate change, as well as from governments’ climate policies. Companies will also have to report greenhouse gas emissions generated directly from their operations and from their energy consumption. They will also have to report what are called Scope-3 emissions from their supply chains and customers if the emissions are material (Editorial Board, *Wall Street Journal*, 2022). These are emissions from suppliers providing inputs to companies, as well as consumers using the companies’ products.

In Canada, Bill C-97, which received Royal Assent in 2019, introduced amendments to the Canada Business Corporations Act that will require corporate boards to disclose certain social information to shareholders, including information relating to diversity on boards and in senior management roles, as well as the well-being of employees, retirees, and pensioners. At the time of writing, these amendments had not yet come into force. Legislation mandating ESG-related disclosures has also been implemented in some Canadian provinces. For example, a 2017 update to the Ontario Pension Act of 1990 requires pension funds in that province to disclose whether ESG factors are incorporated in their statement of investment policies and procedures.⁹ In 2020, British Columbia passed legislation enabling enterprises to register as “benefit companies.” This was done via amendments to the province’s Business Corporations Act. A benefit company is a for-profit, taxable structure that commits to conducting its business in a responsible and sustainable manner that promotes one or

more “public benefits.” This is another example—besides mandating increased corporate disclosure of pertinent information—of how governments are encouraging enterprises to embrace ESG principles.

Private and social benefits of mandating more ESG disclosures

The rationale of new capitalists for broadening the scope of mandated ESG reporting and for standardizing the reporting metrics can be questioned on the grounds that corporate managers and board members better understand the determinants of their organization’s past successes and future risk-adjusted net cash flows than do legislators, regulators, or social and environmental activists. Furthermore, managers and board members typically have strong incentives to disclose information about ESG-related initiatives that promise to increase their organization’s risk-adjusted net worth in the absence of regulatory mandates. As well, institutional and large retail investors with interests in ESG-themed investing can be expected to inquire of companies about their ESG policies and practices in carrying out their fiduciary due diligence. This latter observation further mitigates the likelihood that potentially profitable ESG policies and practices will be unreported by companies in the absence of more stringent disclosure regulations mandated by governments and regulators.¹⁰

Whether expanding standardized regulatory mandates will lead to an improved financial performance of the private sector (or segments of the private sector, such as publicly listed companies) is ultimately an empirical question. While it is beyond the scope of this essay to review the relevant literature in any detail, that literature can be fairly interpreted as offering no consistent support for a positive relationship between the sustainability rankings that companies receive from ESG rating agencies and the stock market performance of those companies. That is, there is no consistent evidence of shareholder benefits associated with a company gaining a reputation as an ESG-conscious organization.

“...there is no consistent evidence of shareholder benefits associated with a company gaining a reputation as an ESG-conscious organization.

This is not to say that there are no external benefits to society from enhanced ESG activities and disclosures on the part of organizations. For example, improvements to the environment may be enjoyed by large portions of society. But if organizations undertaking environmental initiatives are not directly rewarded by the beneficiaries of the environmental improvements, other stakeholders may suffer. For example, employees may be required to accept less compensation if they want to keep their jobs, and consumers may be obliged to pay higher prices if the “do-gooding” organizations from which they purchase goods and services are to remain financially viable. There is no free lunch when it comes to environmental or other societal benefits and imposing social obligations on privately owned organizations makes owners and managers responsible for adjudicating the tradeoffs between helping some groups in society while potentially harming others. It is far from clear that owners and managers of publicly-listed corporations are competent to be given responsibility for adjudicating those



of stakeholders is not a recent phenomenon. Nor are calls for private sector organizations to act sustainably, which encompasses ensuring that there is no net depletion of natural resources over time and that the physical environment suffers no degradation owing to the actions of businesses.

What is relatively new is the growing constituency in the private sector for ESG-themed investing and ESG-consistent business practices, combined with claims that ESG-driven investors and operating companies will perform better financially than other firms while also benefitting the broad society. Relatively new, as well, are calls for more regulation designed to broaden the reporting responsibilities of listed companies surrounding their environmental practices, their hiring and outreach to minority groups, and related matters. In this regard, there is a growing constituency among wealth managers and regulators to impose standardization of ESG reporting. While the ostensible objective is to enhance the “information content” of ESG reporting, it is plausible that the end goal of standardized ESG reporting is an expansion and standardization of regulations of the practices covered by the reported metrics. In this context, there is a risk that the new capitalism is potentially a new road to government as Leviathan.

tradeoffs.¹¹ Major economic and social tradeoffs would seemingly be more appropriately left to elected officials and other public sector bodies that are accountable to legislators and governments chosen through the democratic process.

Conclusion

Some elements of the new capitalist model are hardly new. For example, calls for replacing the fiduciary responsibility of managers to shareholders with a responsibility to a broader set

Endnotes

- 1 Marx (1867/2019) sets out how communism will displace capitalism as the dominant economic system in developed countries, whereas Schumpeter (1942) discusses how the material success of the capitalist system leads to the emergence and growth of economic and social forces that threaten the continued existence of free market capitalism.
- 2 The acronym ESG stands for environmental, social and governance imperatives in investment and management activities. The pillars of ESG imperatives will be discussed later in this essay.
- 3 See Muoio, Bouri and Jurgens (2021) for a description of this project.
- 4 For seminal discussions of the stakeholder capitalism model, see Freeman (1984) and Donaldson and Preston (1995).
- 5 The utilitarian approach to treating stakeholders views any explicit or implicit transaction as being worth doing only if it increases the expected risk-adjusted profitability of the organization.
- 6 A survey of moral arguments for stakeholder capitalism is provided in Burton and Dunn’s study.

- 7 Many economists, for example, argue that stronger private property rights, enforced by laws and the court system, can address many environmental problems conservationists identify.
- 8 See, for example, BNP Paribas (2021).
- 9 See Scanlon (2021) for a discussion of ESG disclosure rules in Canada.
- 10 Many public companies already include some level of sustainability-related disclosures in periodic financial reports and proxy statements filed with regulators.
- 11 This caveat about ceding such decision-making to private sector managers was convincingly addressed by Friedman (1970), who argued that managers have no particular expertise in making such social judgments. Others, including Mehrotra and Morck (2017) argue that shareholder value maximization represents a bright line decision rule, whereas societal (or stakeholder) value maximization is an ill-defined charge to assign corporate boards who would then be in a better position to act in a self-interested manner with respect to shareholders.

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