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OPINION

Social and environmental impact investment

Crisis offers a chance to rewrite accounting to include impact

Investors need to know companies' social and environmental effects

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What if you compared the total environmental cost created by 1,800 companies? You might find for instance that the operations of Sasol and Solvay, two chemical companies with sales of around $12bn each, created environmental damage of $17bn and $4bn a year respectively, while another, BASF, with $70bn of sales, created $7bn.

What if you did the same for the social cost of deficient diversity in the workforce? Take Intel. It pays its 50,000 US employees more than $7bn a year and promotes employee wellbeing and diversity. But if you measure its diversity relative to local demographics, that contributes to reducing Intel's positive employment impact to about $2.5bn.

Should we not be comparing such data across all companies and encouraging a race to the top?

These numbers are revealed by Harvard Business School's impact-weighted accounts initiative, which is led by George Serafeim and chaired by me. We recently published on our website estimates of the environmental impact of more than 1,800 companies, based on public information. Next year, we will add employment and product impacts too, providing a complete picture of the effects companies have. We believe this is the biggest breakthrough in understanding corporate performance since the 1930s.

The Wall Street crash of 1929 made investors realise they did not understand companies' true profits

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The Wall Street crash of 1929 made investors realise they were investing without understanding the true profits of companies. So, in 1933, the US government required all companies to prepare their financial accounts according to "generally accepted accounting principles" and have them verified by independent auditors. This is now the norm.

Representations to the US Congress at the time claimed this would spell the end of American capitalism. In fact, transparency led to huge growth of the investment market, as investors and companies felt they could rely on the US accounting system. Some 90 years on, the Covid-19 crisis has highlighted a similar problem. This time, it is the measurement of companies' social and environmental impacts that must be made transparent.

Today, more than $30tn flows to ESG and impact investments that seek environmental and social improvement alongside profit. As I explain in my book, this is equivalent to one-third of the world's professionally managed assets. Yet investors, as well as consumers and employees, lack transparency on the impacts companies make through their products, employment and operations.

This big investment flow is being driven by a rejection of glaring inequality, unjust discrimination and indifference to the degradation of our environment. These values are widespread among young people, who express them in their everyday choices about which product to buy, company to work for and stock to invest in.

Social and economic inequality frequently erupts into violence, threatening the stability of our societies. Many people in capitalist democracies feel that their economic system does not distribute social and economic outcomes fairly and that governments have consistently failed to redress this imbalance. Meanwhile, the dangerous environmental damage caused by companies mounts. In short, we are creating huge messes, and our governments are expending precious tax resources in unsuccessful efforts to clean them up. Our economic system has become glaringly selfdefeating.

The way out of our dangerous predicament is to measure and value companies' impacts according to "generally accepted impact principles", and to reflect them in financial accounts that show impact-weighted profits. Today's technology and big data allow us to measure and value impacts dependably. If governments force companies to publish impact-weighted accounts starting two years from now, they will immediately start to focus on improving their impact and finding solutions to social and environmental problems.

Echoes of 1929 are in the air. Covid-19 has shaken our habits and beliefs, and caused us to question capitalism. It has opened the door to the urgent change our times demand: to bring impact to the centre of our economic system, to overthrow the tyranny of profit and to shift the basis for our business and investment decisions from risk-return to risk-return-impact. If we seize the moment, we can transform our economies and societies for the better.

We now have the chance to take the next big step forward. By measuring and valuing impact, we can bring the invisible heart of markets to guide Adam Smith's invisible hand and create the kind of world we want to live in.

The writer chairs the Global Steering Group for Impact Investment and is author of 'Impact: Reshaping Capitalism to Drive Real Change'