Purpose vs profit: a false dichotomy

Purpose and profit go hand in hand. If a company doesn't serve society, profits will disappear in the long run.

The forklift driver

Interface is one of the largest carpet manufacturers in the world. It was founded in 1973 and quickly became one of the major carpet suppliers to corporate America. As early as 1994, the company realised that it needed to do more than just make money and shifted its focus to environmental sustainability. Later, the company went further and launched its program 'Mission Zero' to eliminate all negative impacts of the company by 2020.

An executive from a large multinational company visited Interface's factory in LaGrange, Georgia, to learn about its approach to sustainability. She was very sceptical during the presentation and couldn't understand why she had been sent to a carpet factory in Georgia to learn about sustainability. During a break, she walked onto the factory floor and met a forklift driver. When she asked him what he did at Interface, he replied, “I come to work every day to help save the Earth” and then, after chatting for a few minutes, added, “I don't mean to be rude, but if I don't get this roll of carpet to this machine in the next minute, our emissions are going to go out of control. I've got to go.”

The old view

In 1970, Milton Friedman wrote his seminal essay for the New York Times, ‘A Friedman doctrine - The Social Responsibility of Business Is to Increase Its Profits’. This essay is generally regarded as the catalyst, or at least the forerunner, of the new business philosophy of 'shareholder capitalism', where the sole raison d'être is to generate maximum profits for shareholders. However, it must be said that most references are made without actually having read the essay, as Friedman's view is much more nuanced. He argues that the only way a company can focus on long-term profits is by serving society. Friedman (1970): "... it may well be in the long-run interest of a firm which is a large employer in a small community to devote resources to providing amenities for that community or to improving its government. This may make it easier to attract desirable employees". From this we can conclude that even the extreme 'profit only' vision is much less profit only than is generally understood.

The new view

The business world is changing. In 2019, Larry Flink, CEO of BlackRock, the world's largest investment manager with $10.0 trillion in AUM, published his annual letter to CEOs and wrote: "Companies that live up to their purpose and responsibilities to stakeholders reap long-term rewards. Companies that ignore them, stumble and fail." Flink's argument centres on the new generation's focus on purpose, which they expect from the companies they work for, buy from and invest in. Millennials currently make up 35% of the workforce, and in the coming years the largest transfer of wealth in history will begin, with $24 trillion moving from baby boomers to millennials. It seems logical that the words of the CEO of the largest shareholder of virtually every listed company in the world should be taken as more than friendly advice.

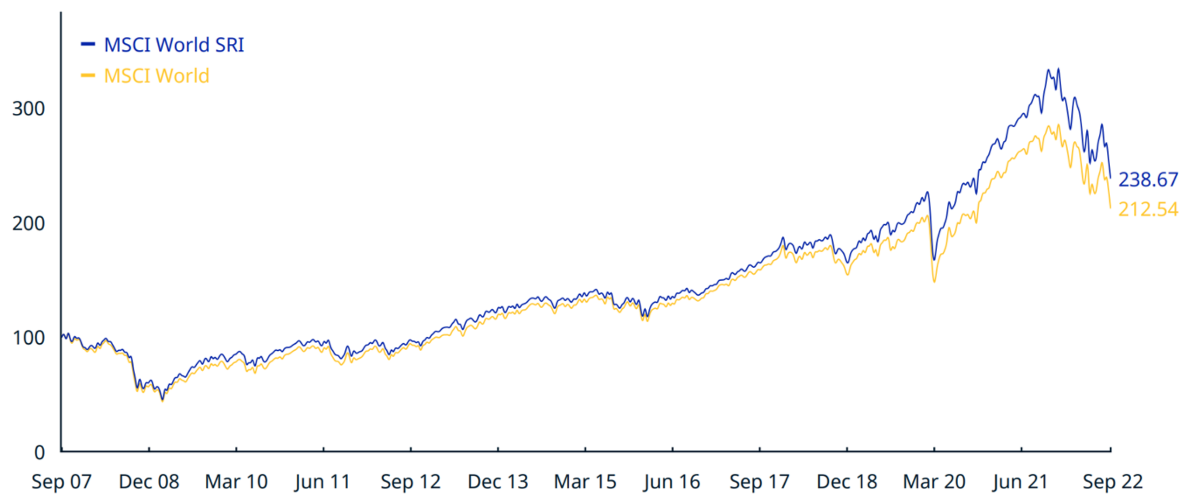
Supporting the argument

The story of the forklift driver illustrates that people, read employees, who have a purpose beyond themselves, are more motivated and willing to go above and beyond. A number of psychological tools have been used to explain this phenomenon. This trait has evolved in Homo sapiens (and probably in other animals) because it strengthens the unity and therefore the resilience of the group. Physically, evolution has created a system whereby oxytocin, serotonin and dopamine are released in the brain when we help others, aptly termed "the helper's high".

The application of this idea in the workplace was illustrated by Edmans (2012), where firm value was measured in terms of job satisfaction. The measurement of firm value was done by taking future stock returns, controlling for risk, firm characteristics, industry performance and outliers, and comparing them to the companies listed in the '100 Best Companies to Work for in America' published and updated by Forbes. The study finds that the top 100 companies outperformed their peers by between 2.3% and 3.8% over the period 1984-2011. Porter, Novelli & Cone (2019) show that 89% of US consumers think positively about, 86% trust and 83% remain loyal to companies that put purpose first. Furthermore, they show that the younger generation is letting this influence where they choose to work, with employees willing to forgo a percentage of lifetime earnings for greater purpose at work. Finally, purpose has been linked to higher employee productivity (Kohll 2018).

There is a lot of research on the relationship between sustainability and corporate financial returns. A 2015 meta-study ("ESG and Financial Performance: aggregated evidence from more than 2000 empirical studies") by Deutsche Asset Management and the University of Hamburg is one of the largest and most important studies on this topic. The research looked at the entire universe of 2,250 academic studies published on the subject since 1970, using data spanning four decades up to 2014. It found that in 62.6% of meta-studies, ESG made a positive contribution to a company's financial performance and in only 10% of cases did it have a negative impact (the rest were neutral). This is further illustrated by the consistent outperformance of the MSCI World SRI Index over the MSCI World Index.

CUMULATIVE INDEX PERFORMANCE — GROSS RETURNS (USD) (SEP 2007 – SEP 2022)



Conclusion

As the title suggests, the idea that an increase in purpose means a decrease in profits is simply unfounded folklore. The founder of the shareholder model thought so, and the above summary hopefully makes it clear that purpose-driven companies perform better because they are preferred by customers, employees and investors. As human beings, we simply feel better when we are doing good, and this increases motivation, stamina and performance.

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Further reading

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