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The necessity of doing well by doing good

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Serving the interests of stakeholders, employees, communities and the broader public is not necessarily at odds with the imperative of profit, write Jan Mischke, Jonathan Woetzel, and Michael Birshan in *Milken Institute Review*.

Sometimes, it's possible to have it both ways. Serving the interests of stakeholders — employees, communities and the broader public — is not necessarily at odds with the imperative of profit. On the contrary, we think it i s essential to achieve that former goal and, more specifically, to make profitability sustainable over the long term.

The pandemic, with its harsh disruptive effects on business and society, has brought this long-controversial notion to center stage, and the recovery will not change that reality. We believe that companies can help buttress aggregate demand and end decades of slow productivity growth, and in the process improve their long-term financial performance.

Under the extreme pressure of the Covid-19 health care crisis that in turn created the deepest economic crisis since World War II, many companies not only responded boldly by adapting through innovation but also, in many cases, chose to work closely with government to mitigate the pandemic. Examples abound from a luxury brand company that repurposed its perfume production lines to make hand sanitizer to hotels that converted otherwise-empty buildings to quarantine facilities.

Businesses, in short, understood they needed to lean in to protect themselves by protecting others. Over the next five years they will need to go further, looking beyond their own P&L in order to promote broad economic growth and thus create shareholder value. The McKinsey Global Institute's new research points to action taken by many firms in response to the economic shock that offers the prospect of delivering a one percentage point increase in annual productivity growth through 2024. That's not small potatoes: in the United States and six large European economies included in this analysis, by 2024 a one percentage point increase would translate into an extra increase in per capita GDP ranging from about $1,500 in Spain to $3,500 in the United States.

However, that potential can only become a reality if aggregate demand remains robust and initiatives to improve productivity diffuse to small and medium-sized companies. And here there is an inherent tension: some 60 percent of the productivity-related actions accelerated by the crisis are efficiency-oriented measures that cut labor and other input costs. Hence the very actions that hold the promise of substantial productivity dividends could also add to longstanding drags on demand and exacerbate inequality.

In particular, there is reason for concern that higher unemployment and increased inequality could result from technological change that disproportionately affects the low-skilled and low-waged, dampening both consumption and investment over the medium term. Consider, too, that large high-performing companies have weathered the pandemic far better than smaller, less flexible firms, particularly in the United States. This has widened the lead enjoyed by so-called superstar firms. Add that factor to the accelerating shift to intangibles like digital services that are largely delivered by STEM workers, and inequality is likely to rise.

We've been here before. In 2018, we wrote in the Harvard Business Review that "demand matters for productivity growth and that increasing demand is key to restarting growth across advanced economies." Then, as now, there were signs of technological progress and operational efficiencies among leading-edge companies, but diffusion was slow and growth was hobbled by weak demand. Back then, we estimated the potential for productivity growth at more than two percentage points. But that opportunity was thwarted by a sluggish macroenvironment that weighed down median wage growth, widened polarization between firms and their workers and dampened investment.

In the decade following the global financial crisis, these factors led to the lowest growth in capital intensity — which spurs labor productivity — since World War II. Even the most productive firms found it difficult to thrive because of weak overall growth.

Social responsibility and sustainable profit go hand in hand, now more than ever. The depth of the economic challenges we currently confront means the first is needed to deliver on the second.

Are we destined for a repeat of this lost opportunity — or worse? The best hope for avoiding an echo of the lax performance of post-financial-crisis years is for businesses to proactively shape the recovery in tandem with policymakers. They can contribute to addressing inequality and wages, and to closing long-running investment gaps not only in infrastructure but also in the environment and in affordable housing. What is good for society can also support value creation by companies. We highlight four areas that companies can look at particularly closely.

Investment in Sustainability

McKinsey surveys find that corporate executives expect sustainability issues to loom ever larger, and see investment opportunities in diverse areas such as hydrogen production and distribution, energy-efficient aircraft, carbon capture, electricity storage and housing. In April 2020, BlackRock (the world's largest asset manager) launched the Global Impact Fund, which focuses on major world challenges, including advancing healthcare innovation, increasing efficiency in water usage, preventing climate change and improving the quality of education.

Given recent innovation that has, for example, sharply reduced the cost of solar power, some opportunities are already "in the money" for companies. Even so, increasing private investment in these areas, or more broadly in areas related to the United Nations Sustainable Development Goals, requires the transparent incorporation of externalities, government incentives and regulatory mandates in business planning. Governments could therefore unlock such investment by setting clear rules and pricing externalities. For example, in a March 2021 Initiative on Global Markets survey, there was overwhelming support from economists for pricing emissions of carbon dioxide and other greenhouse gases.

Spread Advances That Can Boost Productivity Across Business Ecosystems

Many companies are designing strategies that have an impact on their entire supply chains as well as their own bottom lines. Platform organizations in particular could think about how they could enable collaborative progress and innovation helping a long tail of firms with lower technological capabilities to advance.

Northrop Grumman surveyed its suppliers to understand pressure points and needs, accelerating payments to critical small and medium-sized suppliers during the Covid-19 crisis and helping suppliers negotiate the tangle of government regulations. Once key technologies start to mature, tech suppliers can focus on developing products (or variants of products) suited to the needs of small businesses. This includes working on sector idiosyncrasies to identify and develop the services that businesses are looking for and offering support to help with adoption.

Policymakers, for their part, can speed such integration by ensuring that rules governing competition, platform and data access, bankruptcy procedures, product safety and labor environments are all fit-for-purpose, and extending direct support to smaller companies to help them negotiate obstacles. To this end, in March 2021, the UK government approved a £520 million (roughly $720 million) plan for SMEs to make management training, technology advice and discounted software available.

Revisit Wage Norms and Wage Setting

A sustainable recovery will face formidable headwinds unless median wage growth tracks productivity growth more closely than it has for the past half-century. Some companies are responding to the pandemic by looking at ways to strengthen the finances of their most vulnerable workers. In April 2020, for example, Charter Communications announced a plan to raise the minimum wage for its hourly workers to $20 over the next two years. Going it alone on wages is a difficult step for any company that faces competition. But collectively, it could be a win-win, more than offsetting the costs by increased labor productivity through increasing workers' identification with the interests of their employers.

Normalize Lifelong Learning

The pandemic appears likely to contribute to an acceleration in automation, particularly in tasks now employing low-skill labor, making reskilling an urgent priority. Indeed, by giving workers the tools to increase their incomes, training is the most effective way for companies to bolster aggregate demand. Recent MGI research found that, in the United States alone, an additional 5 percent of workers on top of the 22 percent forecast before the pandemic could be displaced by automation by 2030. France, Germany and Spain all face similarly accelerated displacement of labor.

Without the right skills, those workers face unemployment or a squeeze on their wages, both of which would undermine demand — not to mention adversely affect the living standards of the workers and their families. Some companies are responding. Infosys, for instance, has developed employee training programs in the fields of machine learning, artificial intelligence, computer vision and self-driving cars. Faced with a shortage of tech talent, IBM, Bosch and Barclays started apprenticeship programs in early 2020 to train workers for tech jobs with career pathways. Governments are weighing in to support such efforts. In November 2020, the European Commission initiated the Pact for Skills, which provides incentives for businesses and other stakeholders to help overcome the looming mismatch between skills and available jobs.

Unlock Affordable Housing

The rising cost of housing is exerting a drag on consumption. In the United States, housing inflation is estimated to have cut consumption by 1.1 percent in 2019 relative to 2000. State and local governments hold the key to making more land available and changing zoning policies and building codes. But business has a role, too.

Developers and construction firms could embrace modern methods of construction, such as modularization, to reduce cost. Firms could invest explicitly in affordable housing, as Alphabet did in response to the pandemic with the sale of $5.75 billion of corporate environmental, social and governance bonds to fund affordable housing alongside black-owned small businesses and other SMEs badly affected by the pandemic.

Some of what we've recommended here could have applied two decades ago. But a host of factors ranging from the pandemic to Black Lives Matter to rising awareness of climate change have primed the pump. Social responsibility and sustainable profit go hand in hand, now more than ever. The depth of the economic challenges we currently confront means the first is needed to deliver on the second.

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