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A CLEAR CORRELATION

Ethical Companies Outperform

Written by Erica Salmon Byrne

For over a decade, Ethisphere has annually been recognizing companies on the *World's Most Ethical Companies list*. Year after year, we've found that publicly traded companies on that list consistently outperform the markets, with firms in last year's edition outperforming the S&P 500 by 3.3 percent. What's the cause?

The debate continues. Do these companies have more engaged and productive employees? Lower recruitment costs because of lower turnover? An easier time attracting and retaining customers because they are trustworthy business partners? More resources to grow their business because they are not paying fines and legal fees? All of the above? Whatever your view on causation, the correlation is clear: businesses with strong governance practices, better ethics and compliance programs, more committed cultures and a broad engagement with their communities have better business outcomes and higher shareholder returns.

For investors, this is good news, especially as intangibles like reputation become a greater piece of a company's valuation. There is increasing interest in long-term sustainable investing; as of the end of last year, one out of every five dollars under professional management in the US was invested according to socially responsible investment criteria.

So what should investors consider when evaluating a company's commitment to integrity? This can be difficult, as much of this material is internal. Still, from the outside it is possible to get a sense of culture, purpose and metrics.

How to Identify Culture and Purpose as an Investor

Culture was the word of 2015, according to *Merriam-Webster*, and I argue it was important to 2016 as well. Culture and purpose are two sides of a coin, but purpose is easier to see from the outside. Culture reflects a company's values. But purpose connects the heart and the head, motivating employees to do their very best work and leading to a further connection between the head, the heart and the wallet.

Purpose matters, because culture can be difficult to communicate. More companies are seeking to measure the components of culture that have an impact—a comfort level in speaking up, trust in management, a belief in organizational justice. So as an investor, ask whether the companies you're looking to buy into are doing these things.

Purpose can and should be distilled down to two sentences. It's simpler than values and less complicated than a mission statement. Investors, is there a fit between the purpose of a company in which you might invest and that of your own organization? And remember that purpose can be a vital tool in recruiting. This is increasingly important in hiring the best new talent looking for employers that align with their personal values. Investors should be able to glean the organization's purpose from public materials about the company. If you can't do so, be concerned.

Companies that Outperform Have Common Metrics

Specifically, they:

Give the ethics and compliance program the heft it deserves. Organizational charts send messages and who reports to whom matters. Pull up the website of a company you are evaluating. Who is listed in the leadership section? This will tell you something about its priorities.

Invest in front line managers. Ninety percent of the companies recognized by Ethisphere are providing significant training for these managers—the lifeblood of any business—in ethical decision-making and leadership, including effective and ethical hiring practices.

Encourage diversity and inclusion. More diverse companies perform better. A recent report from McKinsey & Company identified a fifteen percent outperformance for companies with greater diversity along gender lines and a thirty-five percent outperformance for those with a broader range of ethnicities within their ranks. As an investor, this is something

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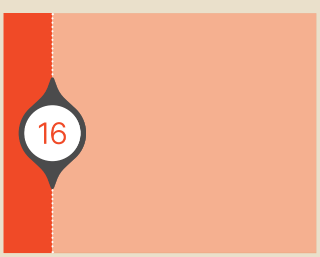
you can definitively evaluate.

Invest in the communities in which they operate. Companies recognized by Ethisphere have a far higher level of community and stakeholder support and are seen as winning the talent battle for the best and brightest employees and directors. More and more companies are varying the location of their board meetings to make them more accessible to employees and key clients and to expose the board to more of the business and to high-potential employees.

Change has been swift. From 2013 to 2016, the percentage of the *World's Most Ethical Companies* that varied their meetings rose from seventy to eighty two percent. Nearly half vary the location at least twice a year. More and more are including key stakeholders like third party partners or clients in board conversations. All of this is information accessible to you as an investor.

Handing your money to a company with the hope they will do the right thing with it and provide you a return is ultimately an act of faith. So the more informed you are about whether the entity on the other end is trustworthy, the better.

Facts & Figures



*Women—accounting for an average of just **16 percent** of the members of executive teams in the United States, 12 percent in the United Kingdom, and 6 percent in Brazil—remain underrepresented at the top of corporations globally.*

Source: *Why Diversity Matters, McKinsey & Company, 2015*

Author Biography

__Erica Salmon Byrne__ is the Executive Vice President, Governance and Compliance at The Ethisphere Institute, and the Executive Director of the Business Ethics Leadership Alliance (BELA).

Responsible for Ethisphere's data and services business, she also works with the BELA community to advance dialogue around ethics and governance. She has been in the governance and compliance space for more than a decade, and writes, speaks and appears frequently on topics of interest to ethics and compliance professionals.