System Change Investing – The Highest Impact SRI

Frank Dixon
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If an asset manager were contemplating the ideal fund in the Sustainable/Responsible Investing (SRI) area, they probably would have at least three requirements – outstanding financial performance, highest possible sustainability benefits and market leadership positioning. System Change Investing (SCI) funds can provide these benefits. SCI represents the most significant SRI transformation in 20 years. It has the potential to capture a large share of the over $20 trillion global SRI market.

Nearly all ESG research, SRI funds and corporate sustainability strategies are focused on reducing negative environmental and social impacts (i.e. company change), for example, by lowering pollution and selling low-impact products. But flawed economic and political systems compel all companies to degrade the environment and society, mainly by not holding them fully responsible. In competitive markets, companies cannot voluntarily mitigate all negative impacts and remain in business. Flawed systems unintentionally create a situation where companies must degrade the environment and society to survive.

There are many specific systems flaws that cause this. For example, the failure to hold businesses responsible for externalities often makes it impossible to eliminate these negative impacts. Time value of money frequently compels companies to treat future people and life support systems as if they were less valuable than present society. Limited liability does not hold business owners fully responsible for negative impacts. Placing shareholder returns ahead of all else often compels companies to negatively impact employees, customers and other stakeholders.

Focusing on economic growth, instead of the actual well-being of society, also drives environmental and social degradation. Allowing regulated entities to inappropriately influence government frequently makes it impossible for regulators to hold companies fully responsible for negative impacts. These and many other system flaws compel companies to degrade the environment and society, which ultimately degrades business, investors and the economy.

Very generally speaking, companies can voluntarily mitigate about 20 percent of short-term and long-term, tangible and intangible, negative environmental and social impacts in a profit-neutral or profit-enhancing manner. Beyond this point, rising mitigation costs often reduce profitability. If companies continue reducing negative impacts, they will put themselves out of business long before reaching full impact mitigation. Beyond a certain point, voluntary corporate responsibility equals voluntary corporate suicide.

Flawed systems, and the reductionistic thinking that created them, are the root causes of the major environmental, social and economic challenges facing humanity. System change probably represents over 80 percent of the sustainability solution. But it gets relatively little attention compared to company change. There are few SRI funds focused on sector-level system change, and even fewer, if any, focused on overarching economic and political system-level change. SCI shifts the focus from company change to system change.

The UN Sustainable Development Goals (SDGs) are one of the most important sustainability movement milestones. By establishing a vision of sustainable society, they will inspire innovative national and corporate sustainability strategies. System change is the most important innovation needed. The SDGs,

and especially the 2030 SDG targets, cannot be achieved without it. The environmental, social and economic problems addressed by the SDGs have a common root cause – flawed systems. Therefore, they have a common solution – evolving systems into sustainable forms. Focusing national, corporate and NGO sustainability strategies on root causes will greatly accelerate SDG achievement.

Many companies are pursuing business opportunities related to the SDGs. But flawed economic and political systems severely inhibit their ability to achieve the goals. System change will greatly expand and accelerate SDG-related business opportunities by frequently making them the profit-maximizing strategies.

The research needed to produce SCI funds could be called ESGS (Environmental, Social, Governance, Systemic). ESGS and SCI are general concepts, like ESG and SRI. Total Corporate Responsibility (TCR®) is a specific ESGS research and SCI fund development methodology. The name refers to companies acting in a fully responsible manner by eliminating all negative environmental and social impacts. System change is needed to mitigate about 80 percent of negative corporate impacts. As a result, TCR is a system change-based approach.

It is focused on the primary overarching system flaw in the business and economic area – the failure to hold companies fully responsible for negative environmental and social impacts. The rule of law is a foundational principle of civilized society. It says that individuals and businesses should be free to do what they want, provided that they do not harm others. Failing to hold companies fully responsible (i.e. allowing them to cause harm) violates the rule of law. This is the general mechanism that puts businesses in conflict with society, and thereby compels them to degrade the environment and society.

TCR is segregated into three performance categories – conventional ESG, sector-level (mid-level) system change and overarching economic and political system-level (high-level) change. The model includes the rating principles, metrics, weightings, data sources and proxies needed to accurately analyze and rate corporate mid-level and high-level system change performance.

The companion book to TCR, *Global System Change: A Whole System Approach to Achieving Sustainability and Real Prosperity*, provides a frame of reference for corporate system change analysis and rating. It identifies the many economic, political and social system changes needed to achieve sustainability and real prosperity, as well as the actions required from different segments of society to practically implement these changes.

TCR and *Global System Change* use whole system approaches. There are many economic and political reform efforts that seek to address one or a few system flaws, such as those noted above. These efforts sometimes have limited impacts because they do not address all relevant factors. Incremental system change guided by a whole system approach produces more effective results. Root causes, systemic barriers, key leverage points, optimal solutions and all other relevant factors are taken into account.

Evolving economic and political systems into sustainable forms is a complex challenge. Society depends on current systems. Changing them could be disruptive. But these systems compel companies to degrade society. They inevitably will change through voluntary or involuntary means. Practical whole system approaches can evolve systems in ways that minimize disruption and protect the long-term well-being of business and society. TCR rewards companies for proactively engaging in these types of system changes.

TCR can be used to develop SCI funds that provide outstanding financial performance and sustainability benefits. The approach enhances returns by identifying financially relevant systemic risks and opportunities and providing an excellent indicator of management quality, the primary determinate of stock market performance. Collaborative system change is the most complex management challenge.

Success in this area requires superior strategic vision, stakeholder engagement and many other skills. Excellent system change performance is a strong indicator of sophisticated management that will perform well in other business areas, and thereby earn superior returns.

TCR and SCI in general are focused on the most important sustainability issue – system change. As a result, they have the potential to provide far greater environmental, social and economic benefits than any other type of SRI.

Corporate profits are near record highs. But they largely are based on huge, unpriced externalities (negative impacts). With information transparency and social media expanding rapidly, businesses no longer can degrade the environment and society with impunity. To protect their brands, reputation and license to operate, companies must greatly reduce negative impacts. System change is the primary action needed to achieve this.

Organizations such as *Focusing Capital on the Long Term* advocate long-term investment approaches. TCR provides a practical and profitable way to engage the corporate and financial sectors in these and other types of business and society-protecting system changes.

Twenty years ago, many companies did not understand the mechanics or benefits of sustainability. ESG models provided a corporate sustainability roadmap. As the financial community integrated ESG performance into investment decisions, companies were compelled to implement sustainability strategies.

The same will occur with system change. As investors measure corporate system change performance, companies will be compelled to manage it. The corporate and financial sectors are powerful. Engaging them in system change is one of the most important system change leverage points.

SCI is the next generation of SRI. Financial organizations that launch SCI funds will be seen as the true leaders and innovators in the large and rapidly growing global SRI market.

A longer version of this article, called System Change Investing – The Next Generation of SRI, is available at www.GlobalSystemChange.com. It provides more detailed responses to two critical financial sector questions – Why should I care about system change? And what can I do about it?

SCI, ESGS and TCR were developed by Frank Dixon. For many years, he oversaw the sustainability analysis and rating of the world's 2,000 largest companies as the Managing Director of Research for Innovest Strategic Value Advisers, formerly the largest ESG research firm in the world. He developed the TCR model and wrote Global System Change to facilitate the system changes needed to achieve sustainability and real prosperity. He has an MBA from the Harvard Business School.

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