T. Teaching Impact

Leadership and business dilemmas that emerge when teaching finance under the new light of sustainability

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Abstract

«Traditional finance may be the single biggest stumbling block to reimagining capitalism». This sentence appears in Rebecca Henderson's best selling book titled: «*Reimagining Capitalism: How Business Can Save the World »,* as one of the key pieces to reform the economic and political system in the right direction. These words generate clear ethical dilemmas for somebody such as myself who teaches finance in a business school like ESCP. Am I, as a finance teacher, one of the main blocks to Save the World? This paper aims to reflect upon the compatibility of finance and the goal of this ESCP's Impact Papers Edition to promote Better Business and Create Sustainable Value.

Keywords: Leadership, Sustainable Finance, Shareholders' Value, Sustainability

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Introduction

The idea to write this paper started when a few months ago I received a phone call from Pablo Sagnier. Pablo and I are good friends from our days at Wharton and McKinsey many years ago, when we were both young. Ever since, we have maintained not only a solid friendship but also actively debate intellectual subjects (in economy and finance among many others). He told me he had been impressed by Rebecca Henderson, whom he had met in a business meeting, and her book Reimagining Capitalism, that he acquired and read immediately. He recommended that I read the book so as to to help him solve his question regarding the implications of the concepts described in the book on the validity of traditional financial concepts like maximizing shareholders' value or estimating a project's net present value as a management decision tool. He wanted to exchange ideas with me, as a friend and as a finance teacher.

My immediate reaction was to connect his question with all the current ideas and trends appearing around sustainable finance. I decided to give him a quick and not very thought explanation and promised that I would give it more profound thought.

Sustainable Finance and European Commission Regulation.

The first thing I discovered was that I didn´t have a good understanding about the meaning of sustainable finance. It is true that I had heard about colleagues from the finance department at ESCP working on these topics and developing new specializations around these ideas but I hadn't found the moment, or the time, to look into it. This ESCP Impact Paper and my friend's question created the perfect opportunity to make the effort.

My first reflection was that it was surprising and intriguing, that since I have been teaching three different financial subjects at ESCP each year since 2015, I had not faced the need to learn about sustainable finance in order to explain it to my students. To confirm I was not wrong, I looked into the index of the three main textbooks that I use in my classes (Berk/DeMarzo, 2020; Mishkin, 2018; Pilbeam, 2018) but I couldn´t find this term or anything similar. At least I felt I was relieved about my lack of knowledge concerning this area, especially because these textbooks are financial world wide accepted bibles, written by prestigious professors from Stanford, Columbia and City-of-London Universities.

With humility, I decided to search for the term "sustainable finance" on Google. What I found was impressively clarifier. One of the first results from this search belongs to the European Commission and it is titled "*Overview of sustainable finance*". It is perfectly structured and very well written, although somewhat bureaucratic, explaining everything about sustainable finance: what it is, why is important, strategies, action plans, commission expert groups, international platforms, related links… There is a lot of information and material around the topic. I discovered it was connected with important European projects such as the European Green Deal Investment, which will mobilize at least €1 trillion of sustainable investment over the next decade. Also, it has been created with what is called "*EU taxonomy*" to create a common language and classification system and a clear definition of what sustainable economic activities are. It announces measures like The Just Transition Mechanism that will be mobilizing at least €150 billion, *"making sure no one is left behind"*.

I felt overwhelmed with all this information. There is a huge amount of money to be distributed to those that are willing to understand all these concepts and to apply for the subsidies in the right format. My first conclusion with this finding is that sustainable finance, at this point, seems not to be part of financial basic theoretical knowledge. However, it is very important from the practical point of view of European regulation for the distribution of enormous amounts of subsidies.

It is easy to reconcile these ideas with my traditional finance classes. As mentioned in Berk/DeMarzo Corporate Finance textbook when talking about The Firm and Society: "*... appropriate public policy and regulation is required to assure that corporate interests and societal interests remain aligned. Sound public policy should allow firms to continue to pursue the maximization of shareholders value in a way that benefits society overall.*" In this case, corporations should calculate the Net Present Value (NPV) of a project that consists in applying for these European Committee subsidies. The incremental earnings would be the result of the extra revenues obtained with the subsidies, the additional expenses to comply with the subsidies requisites (internal team costs; consultancy fees; legal fees; sunk opportunity cannibalization costs...) and the investment required by the application process. Finally, the discount rate should be estimated taken into account that probably the project has a lower beta than other comparable projects.

But is this everything about the connections between finance and promoting Better Business and Creating Sustainable Value? Let´s have a look into some ideas that are coming from the other side of the Atlantic Ocean, from the USA.

Implications for Finance within the principles of Better Business and Creating Sustainable Value from a self-regulation point of view

To continue advancing my knowledge about sustainability I decided to read Rebecca Henderson's best selling book titled: «*Reimagining Capitalism: How Business Can Save the World* » in depth. It is an excellent and inspiring book that has had a profound impact on me. I have learnt and enjoyed much from the reading and it has been much more engaging than when reading and looking at the European Commission web pages.

It is true that there are ideas from the book that I want to emphasize and others that I want to look at with a critical eye from my teaching finance perspective.

In summary, the book reasons that capitalism has been great, but at the same time it has brought huge problems and challenges that need to be resolved, and businesses have to get involved and have to lead this transformation. The following sentences, captured from her book, summarize these ideas: *"Free-market capitalism is one of humanity's greatest inventions... ...At the same time... has led to rampant inequality and the looming of climate catastrophe... ... business can simultaneously make a positive impact on the world... ...while delivering the sustained economic growth that brings prosperity and well-being to society as a whole"*. From my point of view, I basically see these words and ideas as good grounding to start building a Better Business. .

The challenge for me, as a finance teacher, is that the 'Third Piece' of her method to achieve this transformation is what she calls, *"Rewiring Finance"*. She describes this in the following way: *"Traditional finance may be the single biggest stumbling block to reimagining capitalism. As long as investors care only about maximizing their own returns..."*

How can I reconcile this with my finance classes? First, I will look at several finance gurus to discover that what they really say about maximizing shareholders value and the rewiring of finance is not very different from Rebecca's ideas. Secondly, I will look into the pieces she mentions that are already happening to 'rewire finance' and I will express my point of view.

Let's first have a look at the opinion of different financial gurus about maximizing shareholders value. Berk/DeMarzo explains it very clearly in the section about *"The Goal of the Firm"*:

"In theory, the goal of a firm should be determined by the firm´s owners. A sole proprietorship has a single owner who runs the firms, so the goals of a sole proprietorship are the same as the owner´s goals. But in organizational forms with multiple owners, the appropriate goal of the firm – and thus of its managers – is not clear. Many corporations have thousands of owners (shareholders). Each owner is likely to have different interests and priorities. Whose interests and priorities determine the goals of the firm? …shareholders are aligned…because, regardless of their own personal financial position and stage in life, all the shareholders will agree that they are better off if management makes decisions that increase the value of their shares."

I think Berk/DeMarzo's ideas are very interesting for two reasons. First, because they show that current capitalism allows the creation of different types of firms in which the goal does not have to be about maximizing shareholders value at all. In a sole proprietorship, or in a partnership (including private equity and venture capital firms), or in a limited liability company (LLC), the goal of the firm will be fixed by agreement among the few (normally) owners, and of course it can give more importance to social/environmental or other issues over the pure maximization of shareholders' value. Second, because they show that for public corporations with thousands (or millions) of owners, it seems that the best way to align their interests is to encourage management to make decisions that maximize shareholders value. Berk/DeMarzo solution for this it is expressed in his section about *"The Firm and Society":*

"Are decisions that increase the value of the firm's equity beneficial for society as a whole? Most often they are…its customers also are better off with products like (for example iPod or iPhone) that they might otherwise never have had… as long as nobody else is made worse off by its decisions, increasing the value of equity is good for society… When the actions of the corporation impose harm on others (like pollution or products that harm the environment) in the economy, appropriate public policy and regulation is required…"

These sentences are crystal clear in highlighting the role that corporations and government regulation have to play, which is very much in line with the European Commission sustainable finance subsidies strategy that we have mentioned earlier.

Continuing with finance guru's opinion on this topic it is interesting to look at Robert J. Shiller, professor of finance at Yale University, and his book Finance and the Good Society. In the preface he mentions:

"Finance… also acts as the steward of society´s assets and an advocate of its deepest goals… gains made in democratizing finance - extending the benefits into corners of society where they are most needed… this will require all of the imagination and skill that you can bring to bear. Good luck in reinventing finance. The world needs you to succeed."

From Shiller words, it is obvious that to continue reinventing (or rewiring) finance is a must accepted by financial experts; but it is also true that it will require a lot of imagination and skill. I personally wrote an article in this direction in 2008, *"¿Cómo reformar y democratizar el sistema financiero?"*. In Shiller´s book, it is specially pertinent in relation with our topic his chapter about *"The Great Illusion, Then and Now"*. In Shiller's words:

"… the great illusion (Then) was that military conquest brings economic advantage. This misconception existed… and led ultimately to World War I… There is a similar danger (Now) in the idea that people will relentlessly pursue wealth in business, for it too sows mistrust, which in turn diminishes the possibilities for constructive business… Life Satisfaction: Most of the real satisfaction one gets from business is not really closely related to the level of profits… There is absolutely nothing in financial theory that says that people should value making money to the exclusion of all other rewards…it is perfectly consistent with people´s natural willingness to sacrifice some income for quality of life… The futility of conquest in business mirrors the futility of conquest in war…it was impossible to extract much wealth from conquered countries. It is likewise impossible to extract much happiness from wealth that has been earned by antisocial financial means…

And yet there is a common presumption, replicated constantly in the news media, that business is relentlessly selfish – and ready to attack us all, if we ever let our defenses down. This presumption leads to an atmosphere of excessive suspicion and social costs.

Just as the great illusion led in substantial measure to the world wars, so too does that same illusion in business lead to economic inefficiency and disappointment. There is a significant role for people of influence, including educators, in working to correct this illusion, and making that correction will be fundamental step toward building a good society."

I have extended myself too much with the paraphrasing of Shiller's words but I think they are tremendously clear and especially interesting to put Rebecca Henderson's book into context. When she talks about rewiring finance and the problems of traditional finance, many readers can be moved, as Shiller advises, *"to an atmosphere of excessive suspicion and social costs"*. I believe that Shiller's ideas explaining that "*There is absolutely nothing in financial theory that says that people should value making money to the exclusion of all other rewards…"* help to reduce aggression much more (something that Shiller also explains in his book).

Rebecca Henderson talks in her book about *"three pieces that are, fortunately, underway… to reimagine capitalism"*. However, I have the feeling that these pieces are not exactly linked with Reimagining Capitalism, but are perhaps more linked to Traditional Capitalism, making it more in line with Shiller's point of view. Let´s look at this.

The first of Rebecca Henderson's 'pieces' is the so-called ESG metrics. In relation to this, Philip Kotler -- in his traditional and famous book about Principles of Marketing -- was already talking in its 2008 edition about "*the societal marketing concept"* and *"the sustainable marketing concept"* as an evolution of "*the marketing concept"* that traditionally focused only on consumer needs. Kotler's ideas are important in the context of this paper because they were written about marketing as a normal evolution of marketing and not as a revolution of capitalism. In Kotler's words: *"Sustainable marketing is not a retreat in the face of pressure groups or a public relations gambit to counter negative publicity. It is founded on the recognition that the best strategy is to serve the long-term needs of customers and to pursue strategies that are consistent with the long-term survival of a business."* The second 'piece' she mentions is about looking for alternative sources of capital – to so-called impact investors. One of the cases she illustrates is Triodos Bank. It is interesting to note that ultra-left Spanish political party leaders from Podemos, like Pablo Iglesias and Juan Carlos Monedero, have used their client relationship with this bank in a political way to aggressively criticize traditional Spanish financial institutions like Santander or BBVA. Another highlighted case is Mondragón, a firm based in Spain´s Basque region, which is run as a cooperative and has become an important company that employees more that eighty thousand people. In the book it is mentioned that *"One senior manager at Mondragon suggested that the firm played a significant role in reducing* *inequality, claiming that: If the Basque region in Spain were a country, it would have the second-lowest income inequality in the world".* As my mother´s family is originally from this Spanish region that I loved and that I have lost because I had to escape from it due to the terrible divisions of society created by ETA (the ultra-left-wing terrorist organization) and the political manipulation of this situation, it is hard for me to read these messages about equality world leadership. Mondragon and the Basque region political situation is very complex and has had extremely unfair social and business implications than should not be linked, in my opinion, with Reimagining Capitalism. The book "Patria", that has been recreated in an HBO series, explains this quite well.

My objective with these comments is not to criticize Rebecca Henderson's excellent book, but is in line with Shiller´s words; I am trying to reduce the risk of generating mistaken ideas that move into a confrontation of Destroying Capitalism and the Financial System versus a really exciting and innovative process of Reimagining Capitalism and the Financial System where everybody should contribute. For this purpose, members of the Board of Directors with enhanced Governance should play an important role incorporating longer decision making perspective. For example, in the way Simon Sinek explains in his recent book, the "Infinite Game".

All these topics come inevitably with a heavy political and struggle for power load that derives from different democratic private attitudes. For example, it is obvious that for me, the Spanish political party Podemos and the Basque region, are not good ambassadors on How to Save the World and I feel obliged to mention it. This helps me to lead into the topic of Leadership theories as a way of finding a convergence point to facilitate the collaboration of doing Better Business and Creating Sustainable Value among high diversity groups of citizens.

Leadership and Human Values to Make a Change

It is interesting to see how both Shiller and Henderson finish their books talking about leadership. In Shiller´s case it finishes with, *"Epilogue: Finance, Power and Human Values"* and he writes sentences like, *"…part of the reason successful societies develop power elites is that they need a leadership that has the power to get things done…"* In Henderson´s case it finishes with, *"Six Steps to Making a Difference"* and she writes about, *"… Discover your own purpose: … What do you value above everything else?… reflect on the ways in which the problems of our current age have echoed through your own life. Do something now. Bring your values to work. Get political. Take care of yourself and remember to find joy."*

Honestly, this is music to my ears and it opens up for me the opportunity to talk a little bit about myself. At ESCP I decided to teach Finance only to young students between 20 and 25 years old. I also created a fin-tech startup with ESCP students, OpSeeker, to promote financial health mainly among millennials. With more mature students – such as the participants in the MBA or in the Executive MBA programs or in Corporate Executive Education - I prefer only to teach Leadership and more precisely Total Leadership, a methodology develop by Professor Stewart D. Friedman from The Wharton School, my alma mater. In summary, it is a systematic, flexible approach for creating sustainable change to improve performance in all parts of life – home, work, community and yourself. I have been collaborating with him since 2008 and I deeply believe in Total Leadership, more than in Finance, as a management methodology for the XXI century to have an impact and help to make the World a Better and More Sustainable place starting with the individual human being. As Friedman summarizes, *"Be a Better Leader, Have a Richer Life"*

Conclusion

This ESCP Impact Paper's topic about Better Business and Creating Sustainable Value has awoken in me, as a finance teacher at ESCP, some confusions about the validity of traditional financial concepts like maximizing shareholders' value or estimating a project's net present value as a management decision tool. With the reconciliation of these concepts, I feel I have reduced the risk of generating mistaken ideas that move into a process of confrontation to Destroy Capitalism and the Financial System versus a process of a real exciting and innovative way of Reimagining Capitalism and the Financial System where everybody should contribute.

All these topics inevitably come with a heavy political struggle for a power load that derives from different democratic personal attitudes. And most people seem to agree that modern management leadership theories can be an adequate way to find a convergence point to facilitate the collaboration of doing Better Business and Creating Sustainable Value among a high diversity group of citizens. Total Leadership represents an excellent management methodology for the XXI century to have an impact and to help make the World a Better and More Sustainable place starting with the individual human being.

Personally, one idea that has inspired me during my life is the beauty of the poem *Vida Retirada, "…¡Oh campo, oh monte, oh río! ¡Oh secreto seguro deleitoso!…" ("Oh countryside, oh mountain, oh river! Oh secret that is surely delightful!…")* – that I had to memorize when I was a child in the school -, written by the XVI Century Augustinian Spanish priest Fray Luís de León, who probably got the inspiration from the Roman Horatio´s *Beatus ille* verses, *"Beatus ille qui procul negotiis,…" (Blessed is he who, far from business,…)*, written one century BC. It is nice to discover that the love for nature is not a XXI century fashion.

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