VOLUME 33
NUMBER 2
SPRING 2021

Journal of APPLIED CORPORATE FINANCE

Sustainable Financial Management

Columbia Business School

1850 MELIORA
SIMON BUSINESS SCHOOL
UNIVERSITY of ROCHESTER

A Deeper Look at the Return on Purpose: Before and During a Crisis

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In October 2020, we published a study called "The Return on Purpose: Before and During a Crisis" that explored corporate approaches to purpose and their effect on financial performance and value.[1] In this paper, we expand on that study with additional data and deeper analysis of the relationship of purpose to higher performance on financial, valuation, and value creation measures. We complement this with new statistical support to demonstrate the explanatory power of purpose on valuation, even after accounting for financial variables and other fixed effects. We conclude with practical first steps to better operationalize purpose in management decision-making.

The purpose of the corporation is a subject of a longstanding debate. However, a striking feature of the current debate on purpose is the role leading CEOs are playing in it. The Business Roundtable's (BRT) Statement on the Purpose of a Corporation may well be the most high-profile example of this.[2] In that statement, leading CEOs identified a laundry list of stakeholders, including shareholders, who these CEOs expect to hold in view. This type of initiative yields a number of questions. What are its implications for management decision-making? Is this statement a codification of existing practice or does it establish a direction in which the signatories expect practice to develop? How will we know CEOs are living by it across the business and its governance arrangements?

Skepticism about Purpose

Many have expressed a skeptical view of the emerging stakeholder paradigm and the extent of corporate commitment to it.[3] Institutional investors have voiced concern that a stakeholder approach may be used as a pretext for pursuing a policy agenda that seeks to erode shareholder rights, leading to management entrenchment and other externalities. Others have suggested that identifying a stakeholder approach—and a more pro-social stance by corporations—may be an attempt to forestall regulation at a time when corporate practice is under scrutiny.

A further note of skepticism is sounded by groups, including institutional investors, who are asking whether high-profile policy statements by corporations can be reconciled with their much less public lobbying and political contributions. American corporations play a major role in funding the political process, and many question whether a stakeholder approach is consistent with the policy positions taken by groups funded with corporate money.

And even for those who believe the stakeholder focus is credible, it may not be clear how executives should make trade-offs across stakeholder groups.[4] For example, if a strategy benefits consumers, but has negative implications for employees, how is such a strategy decision to be made?

1 Milano, Gregory Vincent and Tomlinson, Brian and Whately, Riley and Yiğit, Alexa, *The Return on Purpose: Before and During a Crisis* (October 21, 2020). Available at SSRN: https://ssrn.com/abstract=3715573 or http://dx.doi.org/10.2139/ssrn.3715573.

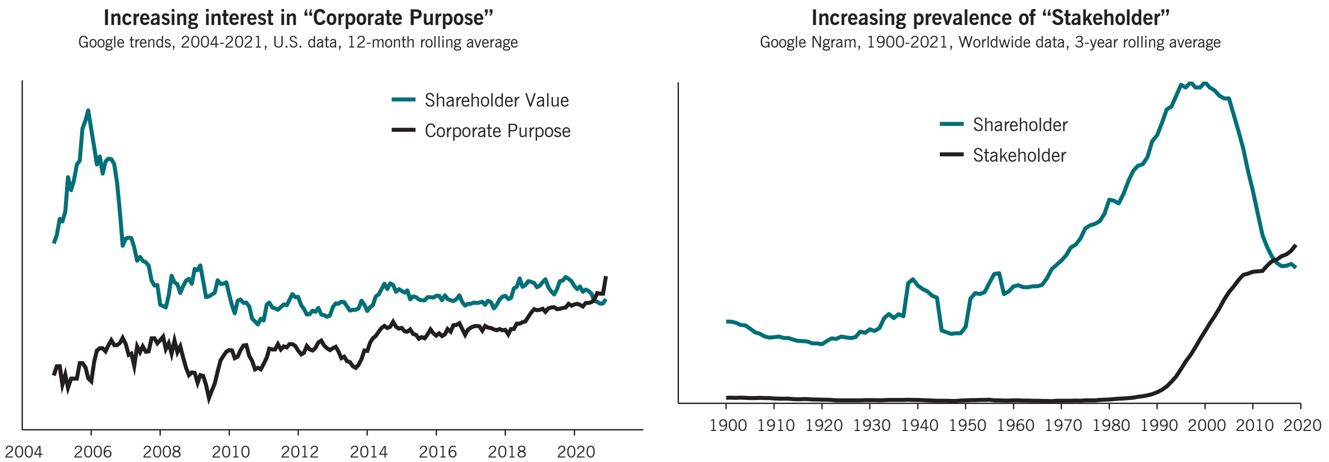
2 BRT Statement on the Purpose of the Corporation (August 2019): https://opportunity.businessroundtable.org/ourcommitment.

3 Bebchuk, Lucian A. and Tallarita, Roberto, The Illusory Promise of Stakeholder Governance (February 26, 2020). Forthcoming, *Cornell Law Review*, December 2020, Available at SSRN: https://ssrn.com/abstract=3544978.

4 Milano, Gregory V. and Chew, Michael, "Value in a Stakeholder World," *Indian Management*, January 2020, https://fortuna-advisors.com/2020/01/18/value-in-astakeholder-world/.

Figure 1

Increased Interest in Purpose and Stakeholder Value in Search Traffic and Printed Material



Trade-offs are also not static, and their characteristics adjust depending on the time frame used to assess them. For example, because the upfront costs to retain and train workers may over time yield benefits in terms of productivity and customer satisfaction, any trade-off cannot be fully assessed over a short-term time horizon. Companies have always made investments that take time to create value—the mismatched timing between an investment and its return gives rise to the very need for capital and *capitalism*—but what managers have lacked—which we seek to remedy—is objective data tying an investment in stakeholders to financial performance and shareholder value.

Such skepticism will continue to inform analysis of corporate behavior, priorities, spending, and policy positions. They represent real questions that corporate managers need to answer about corporate purpose. But the centrality of purpose in the cultural conversation, as suggested by Figure 1, means the issue has earned an enduring spot near the top of the Board and CEO agenda. In our studies, we seek to identify emerging practices and patterns in the stakeholder approach to corporate purpose and to demonstrate that this approach can benefit shareholders as well as other stakeholders.

Statements of Purpose and Emerging Implementation

Companies often issue high-level statements of purpose. Typically, these statements are aspirational, simply descriptive, or amount to a declaration of common sense, given the activity of the business, such as those of Walmart and Citigroup:

"We save people money and help them live better."

"We responsibly provide financial services that enable growth and economic progress."

Institutional investors expect corporations to have an authentic statement of purpose—but the statement is just the start. More interesting is to get a sense of how a clearly stated corporate purpose is operationalized within the business and how it features in management decision-making. As we'll show, market valuations reflect investor expectations that purpose-driven companies are likely to be more coherently managed and more resilient, with stronger incentives and greater ability to innovate and respond to disruption. But it is not enough to just invest in purpose; companies must invest wisely and well.

In our work empowering corporate leaders to communicate their long-term value to investors effectively, we recommend that companies provide examples of how "purpose" is operationalized. A number of possible approaches can be used to achieve this in the context of an investor presentation.

Some companies—like Nestle and Prudential Insurance, for example—have identified the key elements of their corporate purpose in retelling the story of the company's origins. Using salient examples derived from the core business, these companies communicate how the stated purpose affected management's decision-making. Such decisions could take a number of forms—limiting share repurchases to preserve financial flexibility to maintain current employment levels and benefits through temporary dislocations, or to fund workforce transition to new offerings that align to broader market changes. Having taken such decisions, companies can then feature these as providing teachable moments in management training and development programs—an approach illustrated in recent CECP CEO Investor Forums by both Alex Gorsky, CEO of Johnson & Johnson, and former CEO Paul Polman of Unilever.[5]

But when communicating their approach to addressing stakeholder requirements and concerns, management teams need to provide visibility on the identification and prioritization of key stakeholders and the feedback mechanisms for evaluating stakeholder outcomes. One technique is to disclose a stakeholder-focused materiality assessment with explanatory commentary on how it was developed, how it is overseen, and how regularly it is refreshed. In addition to external visibility, it is important to articulate how such insights inform decisions internally. Nestle provided an example of this at a recent CEO Investor Forum.[6] The company set out a materiality matrix that was prepared by its risk group and reviewed annually by the board and more frequently by the executive committee. The presentation also led to a discussion of initiatives that operationalized the key issues set out in the matrix.

One emerging approach to purpose begins with statements of corporate purpose issued by corporate boards. Many institutional investors have indicated their preference that boards not only oversee but "own" a company's purpose as part of the framing of its strategic direction and positioning. A board-issued purpose statement is a structured means for the board to identify its key stakeholders, how it expects to oversee them, and the time horizon over which the company sets strategy and manages the business.[7] This approach also has the virtue of setting the goals around purpose at the highest governance level of the firm, providing air cover for management to pursue a long-term, purpose-driven strategy.[8]

Empirical Relationship of Purpose to Value Creation

A growing body of research, which our study builds on, suggests that purpose driven-companies are associated with a variety of performance benefits. Studies have found a significant association between a company's purpose and higher rates of productivity, growth, and employee retention.[9] Evidence also suggests that companies demonstrating clarity of purpose across management teams exhibit systematically higher financial performance and shareholder value creation over the long term.[10] Other studies have reported that companies that outperformed on revenue growth linked all of their strategies and practices to various dimensions of purpose.[11] And our prior research found that companies recognized on both Fortune's Most Admired Companies list and the Forbes' Just 100 list delivered median cumulative total shareholder return that over a five-year period was 41.5% higher than the median of the S&P 500 index.[12]

With the aim of deepening our understanding of the relationship between purpose and measures of company financial performance, market valuation, and shareholder value creation, we analyzed a new purpose metric developed by BERA Brand Management, the world's largest brand-equity assessment platform. BERA captures over one million consumer perceptions across over 4,000 brands to provide a real-time measure of a brand's evolution, prescribe brand actions and predict future financial performance.

BERA's data encompasses emotional, functional, experiential, and purpose-related attributes. The data is collected from multiple consumer panel surveys where consumers are asked whether or not they associate a given brand with a tested attribute. Raw data is then aggregated for each brand and indexed on a scale of 0 to 100 against the full universe of brands tested. As an example, a survey question on the "Point of View" attribute, which is part of the Protagonism dimension, may ask a consumer if Nike is "not afraid to voice a point of view on social issues." The raw number of "yes" responses will be indexed to 100 relative to all other brands in the BERA universe. On this attribute, Nike measured in the 94th percentile of all tested brands.

By measuring consumer perceptions of a brand's relationship to different attributes rather than the brand's own

5 Tomlinson, Brian, Emerging Practice in Long-Term Plans: How CEOs Talk About the Long Term (October 2018). *CECP: Strategic Investor Initiative White Paper Series 2*, Available at SSRN: https://ssrn.com/abstract=3350117.

6 Tomlinson, Brian; Sahin, Julia; Scott, Lauren and Suvanto, Lex, *The Long-Term Imperative: How Companies Can Respond* (January 2020): https://www.edelman.com/insights/the-long-term-imperative-how-companies-can-respond.

7 Eccles, Robert G. et al., 3 Ways to Put Your Corporate Purpose into Action, (*Harvard Business Review*. 2020): https://hbr.org/2020/05/3-ways-to-put-your-corporate-purpose-into-action.

8 Enacting Purpose within the Modern Corporation: A Framework for Boards of Directors (Enacting Purpose Initiative, August 2020): http://enactingpurpose.org/assets/enacting-purpose-initiative—-eu-report-august-2020.pdf.

9 "Millward Brown, in Partnership with Jim Stengel, Reveals the 50 Fastest-Growing Brands in the World and Uncovers the Source of Their Success." 17 Jan. 2012, www.businesswire.com/news/home/20120117005066/en/Millward-Brown-Partnership-Jim-Stengel-Reveals-50.

10 Claudine Gartenberg, Andrea Prat, and George Serafeim, "Corporate Purpose and Financial Performance," *Organization Science* 30, no. 1 (January–February 2019): 1–18. See also Session IV of the conference transcript in this issue.

11 "Insights2020: Facing 2020 with 20/20 Vision." ARF the Advertising Research Foundation. (n.d.). https://thearf.org/category/news-you-can-use/insights2020-facing-2020-with-2020-vision/.

12 Milano, Gregory V.; Chew, Michael, and Kim, Jinbae, "Companies That Do Well Also Do Good," CFO.com, May 15, 2019, https://fortuna-advisors.com/2019/05/15/companies-that-do-well-also-do-good.

Figure 2
Components of BERA's Purpose Score: Four Dimensions and Thirteen Attributes

Universal Connection	**1** **Personal Connection** Amazon *". . .relevant to my life"*	**2** **Inclusive** Walmart *". . .is designed for everyone"*	**3** **Emotional Connection** Coca-Cola *"I feel an emotional connection to this brand."*		
Consistent Focus	**4** **Employer Brand** Google *"I imagine this would be a good brand to work for."*	**5** **Innovative** Tesla *". . .innovates with purpose"*	**6** **Stands Out** Apple *". . .stands out from competitors."*	**7** **Appropriate** John Deere *"I see the brand in places that are fitting."*	**8** **Clarity** BMW *". . .purpose is clear in its look and feel."*
Social Impact	**9** **Humanitarian** Walgreens *". . .addresses human needs or aspirations."*	**10** **Beliefs/Values** Starbucks *". . .has a clear set of beliefs."*	**11** **Societal Commitment** UPS *". . .a commitment to society."*		
Protagonism	**12** **Point of View** Nike *". . .not afraid to voice a point of view on social issues."*	**13** **Culturally Relevant** Netflix *". . .part of the cultural conversation."*			

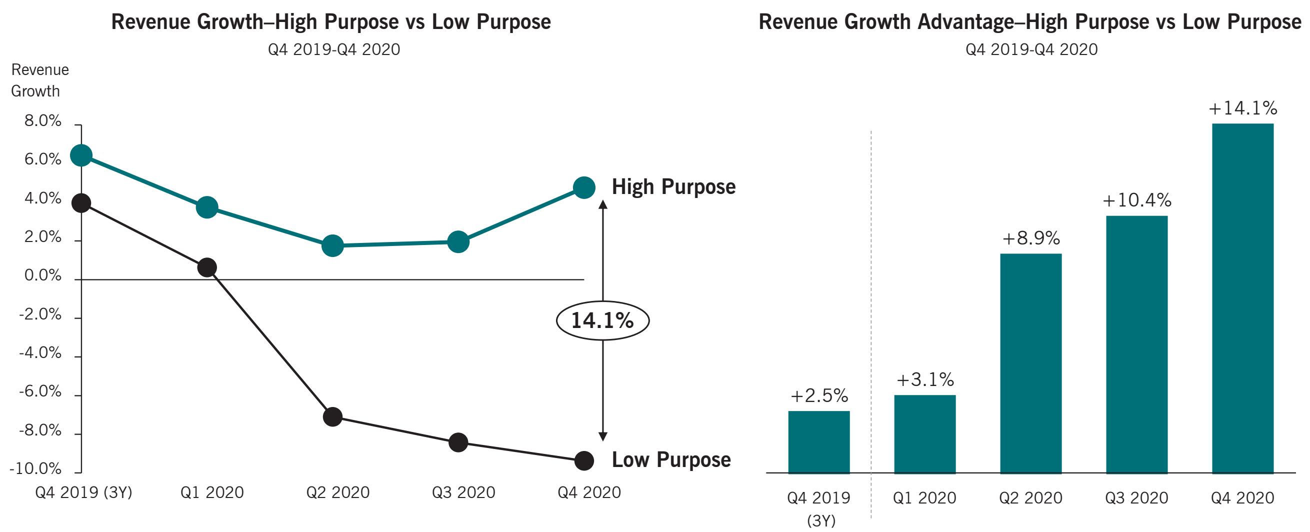
statements, the data provides an objective, third-party view of whether or not a company's actions successfully translate to an outcome with consumers. This also attempts to address concerns of "greenwashing" where a brand's statements on purpose may be inconsistent with actual business practices. Over time, such inauthenticity will make its way into consumer perceptions about the brand and be reflected in the dataset.

Although purpose itself may be a nebulous concept, it arises out of specific actions and strategies to create meaning in the minds of consumers. BERA evaluated over 50 different purpose-related attributes and identified the 13 that showed the strongest statistical relationship to value creation outcomes. The purpose "score" is an aggregate measure of these 13 attributes, which are grouped into four dimensions (shown in Figure 2). When we speak about a company's investment in purpose, we are really speaking about investment in these individual 13 attributes that are actionable at the brand strategy level. Improving performance on these attributes strengthens a consumer's relationship to and alignment with a company's purpose, thereby creating an intangible asset from which long-term profitable growth is expected.

The 13 purpose attributes are measured across BERA's full universe of currently tracked brands. To relate brand-level measures of purpose to externally available company-level financial and value creation measures, we narrowed the scope to 104 "monobrands"—cases in which a single brand accounted for the substantial majority of revenue for their respective publicly listed companies and where financial data was available for all periods of the study. Throughout the discussion of the research, where we use the terms "brands" or "companies," we are typically referring back to the companies within this dataset, though we discuss how these findings can be applied more generally to companies in other sectors.

Our initial study, which was published in October 2020, used purpose data collected during the four months before and three months after the peak COVID market disruption in March 2020. Pre-COVID relationships relied on market and reported financial data for the 2019 calendar year. Post-COVID relationships relied on market data reported through June 2020. In our revised study, we used purpose data collected monthly from January to December 2020. Financial data was gathered for the three years ending December 2019 to measure a pre-COVID

Figure 3
Revenue Growth Advantage of High Purpose Companies



baseline and gathered quarterly during 2020 to evaluate performance as the COVID market disruption and recovery unfolded.

The Analysis

This data enabled us to build a picture of what a high purpose brand looks like in the eyes of the consumer, in company financials, and in the view of investors. We can answer questions on whether brands that invest well in purpose deliver higher margins, stronger growth, and greater shareholder returns. And we can see whether the bonds built by effective investment in purpose translate into more resilient financial and capital market performance in the face of exogenous shocks like a global pandemic.

We developed this analysis in two stages: a cohort analysis to build a general picture of how high and low purpose companies perform; and a multivariable regression analysis to measure the explanatory power of purpose while controlling for variation in financial performance and other fixed effects across the population.

For the cohort analysis, we sorted the brands according to their purpose scores, categorizing those with scores below median as "Low Purpose" brands and those above median as "High Purpose" brands. Pre-COVID analysis relied on purpose scores during the first three months of 2020. Quarterly performance during 2020 was based on year-to-date purpose scores as of each quarter. For each cohort, we measured median performance on a series of financial, valuation, and value creation metrics.

High Purpose Companies Deliver Stronger, More Resilient Revenue Growth

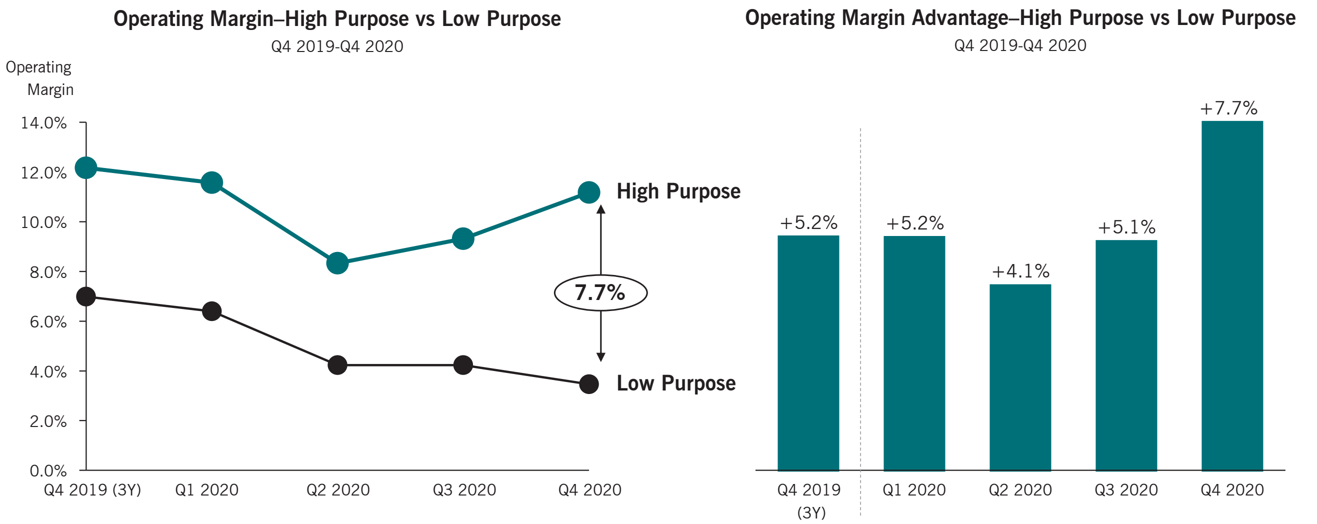
During the three years ending in December 2019, we found that High Purpose companies delivered median revenue growth of 6.4% per year while Low Purpose companies delivered median growth of 4.0%—a 2.5% gap (rounded). Across the four dimensions of purpose, companies that scored highly on Protagonism had the widest advantage, with +2.7% incremental growth. This finding suggests that while some have questioned the role of businesses taking a stand on issues that consumers view as culturally relevant, these stances not only deepen consumer engagement, but are also positively related to substantial incremental revenue growth. In fact, a recent survey of 30,000 consumers by Accenture found that 62% wanted companies "to take a stand on current and broadly relevant issues like sustainability, transparency or fair employment practices."[13]

As the COVID shock developed during Q1 and early Q2 2020, many companies—both High and Low Purpose—faced declining revenue growth, but the impact to High Purpose companies was far less severe. As a result, High Purpose companies dramatically expanded their incremental revenue growth advantage over Low Purpose companies from 2.5% to 14.1% over the course of the year.

Research conducted by our data partner BERA provides insight on how high purpose relates to improved revenue

13 Kevin Quiring, "From Me to We: The Rise of the Purpose-Led Brand," December 8, 2018, *Accenture Strategy Global Consumer Pulse Research*.

Figure 4
Profitability Advantage of High Purpose Companies



growth. Revenue is a function of quantity and price. Elasticity studies evaluate the trade-off between these two. Increase price and typically quantity or demand will go down; decrease price and demand will typically go up. But elasticities are based on a static assumption of the value to the consumer. Increase the value to the consumer and the elasticity is reset, allowing a company to realize increases in volume or price, or both.

The research on changes in consumer behavior in response to purpose suggests an impact on both demand and price. Consumers are making more mindful purchase decisions and seeking out purpose-driven companies that appear to reflect their personal values, beliefs, and impact objectives. In response, companies are establishing deeper connections with consumers by aligning their purposeful practices across their lines of business and brands with environmental or social impact.[14] The interaction of consumer engagement with corporate purpose is a key aspect of purpose that our study seeks to examine. We find that consumers demonstrate higher consideration, stated usage, and preference for High Purpose companies, and that High Purpose companies also benefit from higher pricing power as purpose increases consumers' perception of value and willingness to pay. Importantly, the studies also show that this holds for companies that have both high and low brand equity scores, but the impact is much greater when purpose is aligned with and reinforces strong brand equity.

14 Ulrich Atz, Tracy Van Holt, Elyse Douglas, and Tensie Whelan, "The Return on Sustainability Investment (ROSI): Monetizing Financial Benefits of Sustainability Actions in Companies," July 8, 2019. *Review of Business: Interdisciplinary Journal on Risk and Society* 39, no. 2, 1-31.

High Purpose Companies Deliver Stronger, More Resilient Profitability

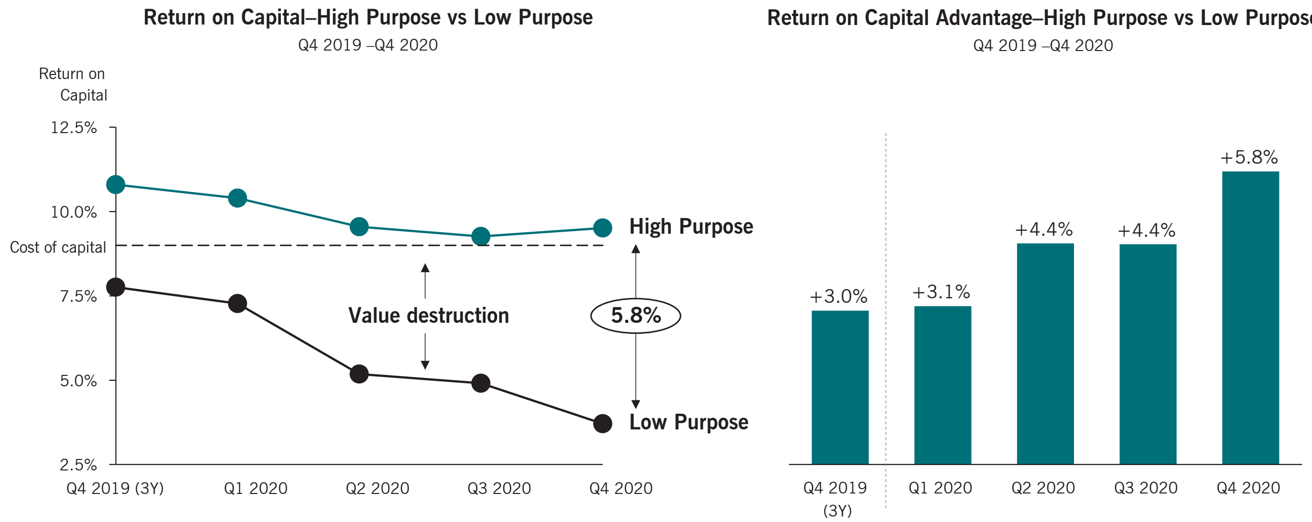
High Purpose companies also delivered stronger, more resilient profitability before and during the COVID shock. From 2016-2019, High Purpose companies delivered median operating margins of 12.2% while Low Purpose companies delivered median operating margins of 7.0%. As with revenue growth, companies scoring highly on Protagonism (Point of View and Culturally Relevant attributes) achieved the widest advantage with operating margins 7.7% above those of low-scoring companies.

Both High Purpose and Low Purpose companies saw median operating margin declines during the first half of 2020, but paths diverged materially after that. High Purpose companies saw median operating margins rebound while Low Purpose companies continued to trend down. The gap between High and Low Purpose companies widened in both Q3 and Q4 of 2020, with High Purpose companies reaching a 7.7% operating margin advantage over Low Purpose companies.

Long-term profitable growth is one of the most common strategic goals that companies communicate to their investors, but in our experience, many companies struggle to navigate the trade-offs between profit and growth. This is particularly true when we look at purpose as a driver of future growth since many of the investments that translate to improved purpose occur on the income statement—that is, they are treated as an expense and deducted from current profitability. Yet the findings are clear that companies in our dataset that invest well

Figure 5

Return on Capital Advantage of High Purpose Companies



in purpose have consistently higher profitability than those that do not. More generally, there should no longer be a question of whether purpose and profit are mutually exclusive.[15] They are in fact mutually reinforcing.

High Purpose Companies Achieve Higher Returns on Capital

To generate value for shareholders, companies must earn a return on invested capital in excess of the cost of capital. The "return" portion is typically measured as the net operating profit after tax (NOPAT).[16] We saw that High Purpose companies delivered substantially higher operating margins. If we conservatively assume that capital intensity is unaffected by purpose, the higher NOPAT would translate to higher returns on capital, and this is exactly what we find in the data. Over the last three years, High Purpose companies delivered 10.8% returns on capital while Low Purpose companies delivered 7.8% returns on capital. If we assume a simple 9% cost of capital, we see that High Purpose companies on average create incremental value for shareholders while Low Purpose companies destroy shareholder value.

As the economic shock of COVID developed during the course of 2020, the compression of operating margins led to declining returns on capital for both High and Low Purpose companies. But as with other measures, the impact was much more significant for Low Purpose companies. Already failing to meet the cost of capital before COVID, Low Purpose companies saw their returns on capital cut in half during COVID. As a result, the median return on capital advantage for High Purpose companies nearly doubled during 2020 from 3.0% to 5.8%.

The consistency of the outperformance of High Purpose companies may seem counterintuitive to those aware of companies that have achieved financial and even stock market success through strategies and tactics that seem at odds with purpose. This certainly happens, and some industries or parts of the value chain may seem less sensitive to purpose than the consumer-facing companies in our dataset. But the significance of purpose suggests a broader impact across the economy. There are already examples where consumers have voiced concerns about a company's supply chain activities being inconsistent with their consumer-facing brand. As consumers' access to information and education about how a brand does business grows, we expect to see companies increasingly adopt backward integrations of purpose into their manufacturing and supply chain choices.

High Purpose Companies Receive Higher Market Valuations

Capital market fund flows and valuations reflect investor expectations that purpose will play an increasing role in shareholder value creation going forward. Much has been written about fund flows into ESG-related funds, which now account for nearly 40% of global professionally managed assets. This growing investor demand likely contributes to the higher valuations High Purpose compa-

15 Sheryl Estrada, "PayPal CFO: 'Profit and purpose are not mutually exclusive,'" *Fortune*, May 26, 2021.https://fortune.com/2021/05/19/paypal-cfo-profit-and-purpose-are-not-mutually-exclusive/.

16 We assume a flat 25% tax to calculate the net operating profit after tax.

Figure 6
TEV/EBITDA Advantage of High Purpose Companies

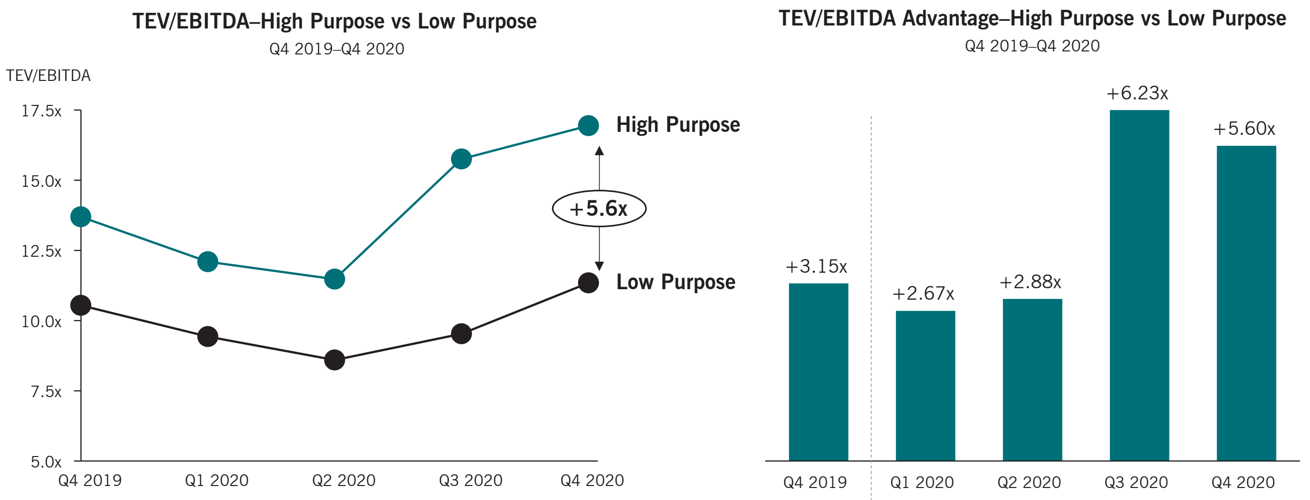
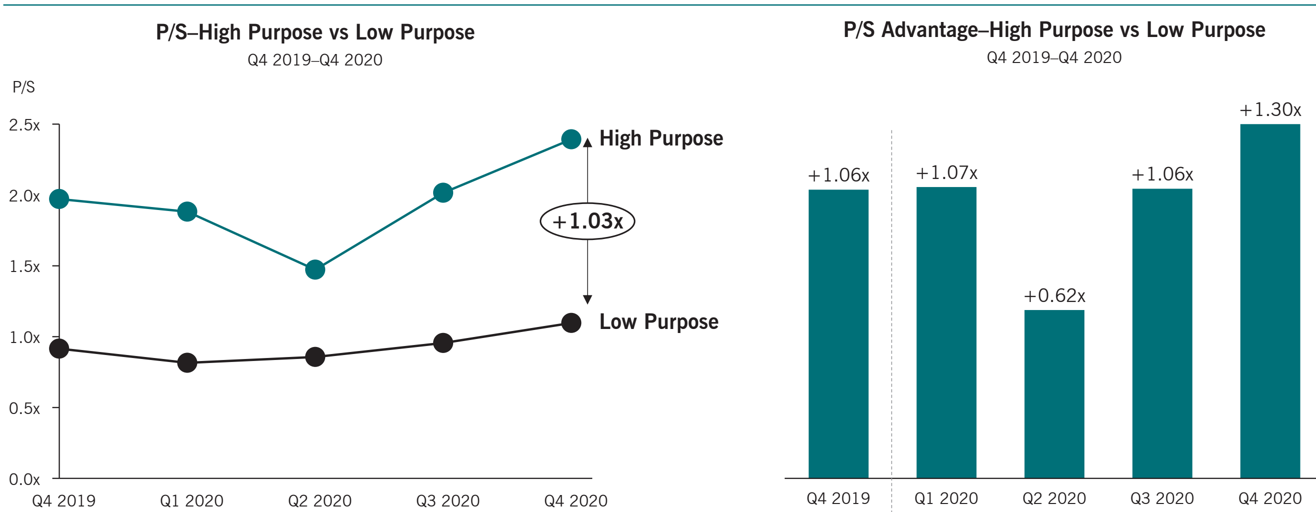


Figure 7
P/S Advantage of High Purpose Companies



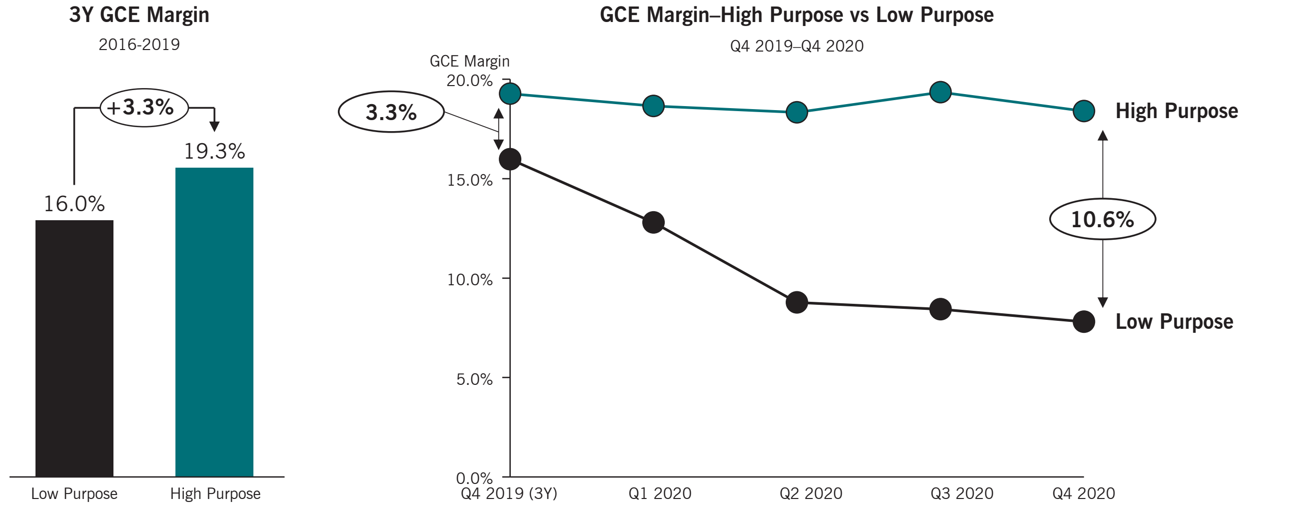
nies consistently earn over Low Purpose companies. Over the last three years, High Purpose companies earned TEV/EBITDA multiples over three turns higher than Low Purpose companies, and P/S multiples more than double those of Low Purpose companies. Both valuation multiples compressed in the first half of 2020, but High Purpose companies rebounded strongly in the second half of 2020, widening the TEV/EBITDA gap to Low Purpose companies by over 70% to +5.6x and widening the P/S gap to Low Purpose companies by over 20% to +1.3x.

High Purpose Companies Generate Greater Reinvestable Cash Flows

Higher valuation multiples reflect investors' expectations that High Purpose companies will generate increased future intrinsic value. This future value creation is determined by how well a company allocates its capital and resources to compound the value of that capital over time. Return on capital is a common metric for investors to assess future value creation, but it can lead to mixed signals for company managers trying to allocate capital to increase intrinsic value. The data strongly suggests that purpose builds consumer relationships to create an intangible asset that

Figure 8

Gross Cash Earnings Margin Advantage of High Purpose Companies



delivers revenue beyond the current period; yet unlike an investment in tangible assets, much of the related cost of purpose is expensed on the income statement as a reduction in current operating income and return on capital. Company managers are then left to contend with the paradox of increasing longer-run return on capital by at first taking actions that reduce it in the short term. This can be a tough ask, especially when company managers may have annual performance bonuses linked to increasing operating income or return on capital, as is often the case. Instead, it can be helpful to think about why return on capital is important, and how we might change our interpretation of it to reflect changes in the profile of cash going into and coming out of new forms of investment.

Most of our financial reporting standards and government economic data are built on the premise that growth derives principally from capital expenditure on tangible assets such as property, plant, and equipment. You build a factory to produce a good; if you want to grow, you build a new factory to increase output of that good. Each factory has a large one-time cost, and companies don't typically sit on large one-time buckets of cash. Investors do sit on large buckets of cash and have no factories to build, so investors provide capital to companies in exchange for an expected return on that capital. If companies want to grow—say, by building a new factory—they need to promise a sufficient return on capital to attract new investment. In such cases, return on capital is a good metric for investors and managers alike.

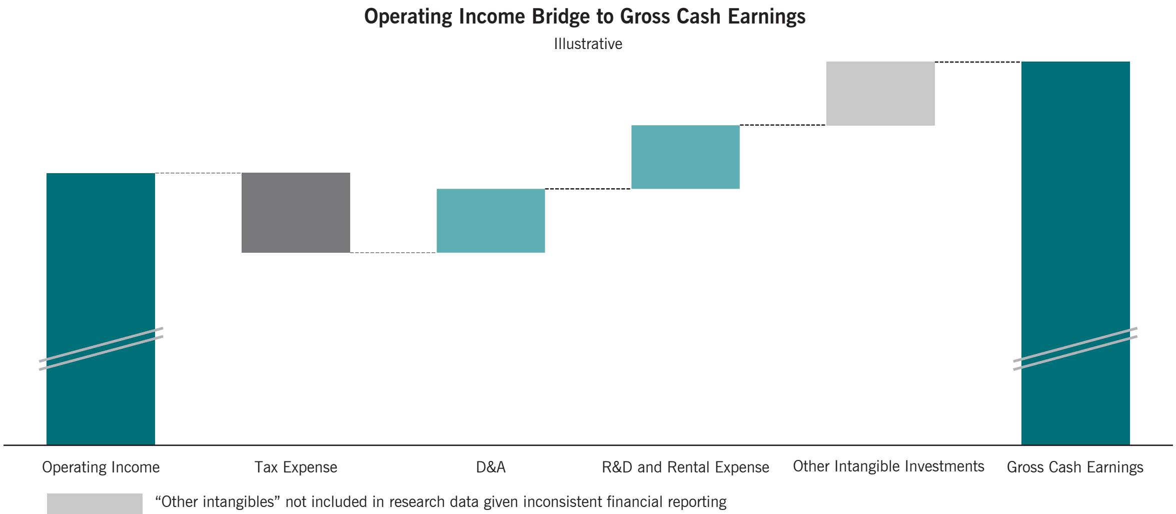
While reporting standards and government data have evolved over time, their evolution is far slower than the economic activity they are intended to describe. Today, investments in intangible assets far outpace those of tangible assets. The cash flow and asset value profiles of growth derived from intangible assets look very different than the growth associated with tangible assets. Intangible assets are not built through large one-time outlays of capital. Capital and capitalism are still important, but capital needs are spread over time because intangible assets are built over time. It is less about concentrated investment than about effective reinvestment of internally generated capital or cash flow.

We use a metric called Gross Cash Earnings to measure the level of reinvestable cash-based earnings available to management to reinvest in growth (see inset box for explanation of Gross Cash Earnings). Gross Cash Earnings starts with net operating profit after tax and then adds back non-cash expenses and P&L investments like R&D. During the three years ending in 2019, High Purpose companies delivered Gross Cash Earnings margins that were 3.3% higher than those of Low Purpose companies. This gap expanded dramatically during 2020, when Low Purpose companies saw their Gross Cash Earnings margins cut nearly in half. High Purpose companies, by contrast, saw almost no impact to their Gross Cash Earnings margin.

We use a company's level of reinvestable cash flow as measured by Gross Cash Earnings as the basis for understanding whether or not management is a good allocator

Figure 9

Illustrative Operating Income Bridge to Gross Cash Earnings



GROSS CASH EARNINGS

Gross Cash Earnings was developed through empirical research to better analyze how management creates sustainable value from the level of cash-based earnings available to them.[17] As the name suggests, this is a cash-based measure of earnings that is "gross" of certain costs—essentially, it is the "free cash" available to managers to reinvest, rather than traditional "free cash flow" that looks at what is available to shareholders after management decisions.

Like EBITDA, Gross Cash Earnings adds back non-cash expenses that relate to prior management investments that reside on the balance sheet (i.e., depreciation of tangible assets and amortization of intangible assets held on balance sheet). But we also add back cash expenses on the income statement that should be treated as investments. The classic example of this is R&D, and in fact, under international financial reporting standards, the "development" part of R&D is capitalized on balance sheet rather than deducted from earnings. GAAP accounting doesn't split these in reported data, so we add back all of R&D and capitalize it on the balance sheet for a defined period. We also add back rental expense to eliminate distortions of lease/buy decisions and capitalize that on balance sheet for a defined period. Conceptually, Gross Cash Earnings should treat all income statement expenses that generate revenue beyond the current accounting period as investments, including intangibles.

of capital. How well a company actually reinvests their Gross Cash Earnings determines future value creation. We look at two key drivers for that: a "Reinvestment Rate"[18] that measures how much a company reinvests, and "Reinvestment Effectiveness,"[19] which measures how well that reinvestment translates to incremental revenue.

High Purpose Companies Reinvest Capital More Effectively Than Low Purpose Firms

As we've seen, High Purpose companies delivered stronger growth and greater profitability than Low Purpose companies before and after the COVID shock. They accomplished

17 Gregory V. Milano, "Postmodern Corporate Finance," *Journal of Applied Corporate Finance*, 22(2), 48-59, 2010. https://doi.org/10.1111/j.1745-6622.2010.00273.

18 What qualifies as reinvestment varies by company, but for research purposes we define "Total Reinvestment" uniformly as the sum of capex, changes in net working capital, R&D, and cash acquisitions. To get Reinvestment Rate, we divided Total Reinvestment by Gross Cash Earnings. This tells us the percentage of cash earnings available to management that is reinvested back into the business to fund future growth and cash flow generation.

19 Reinvestment Effectiveness is defined as the change in revenue during a period, divided by Total Reinvestment during a period.

Figure 10

Reinvestment Rate and Reinvestment Effectiveness Advantage of High Purpose Companies

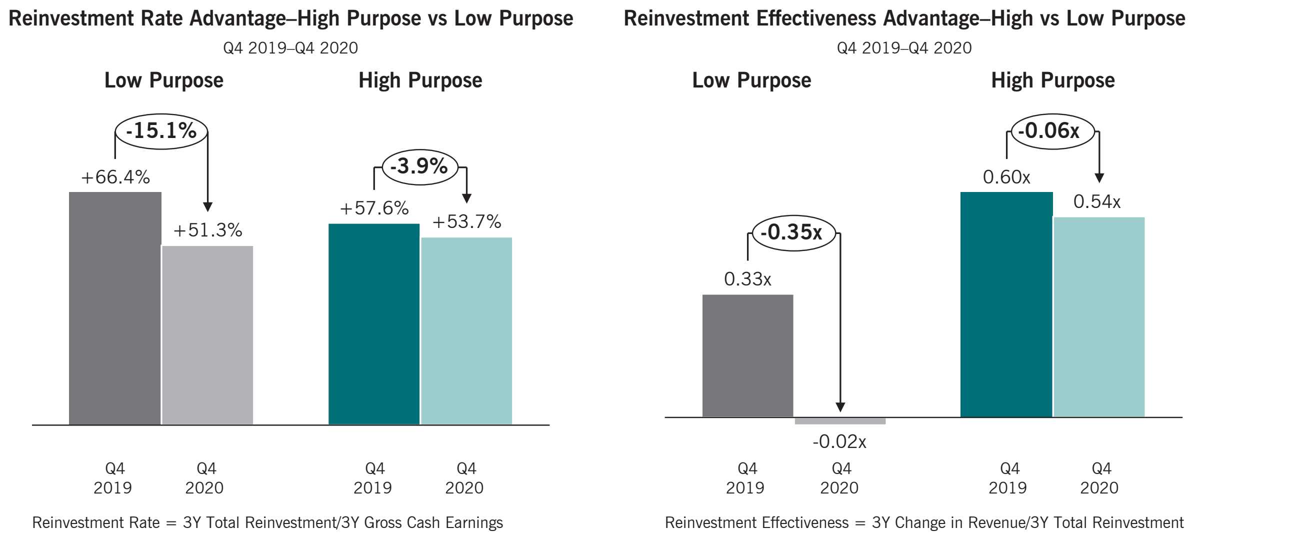
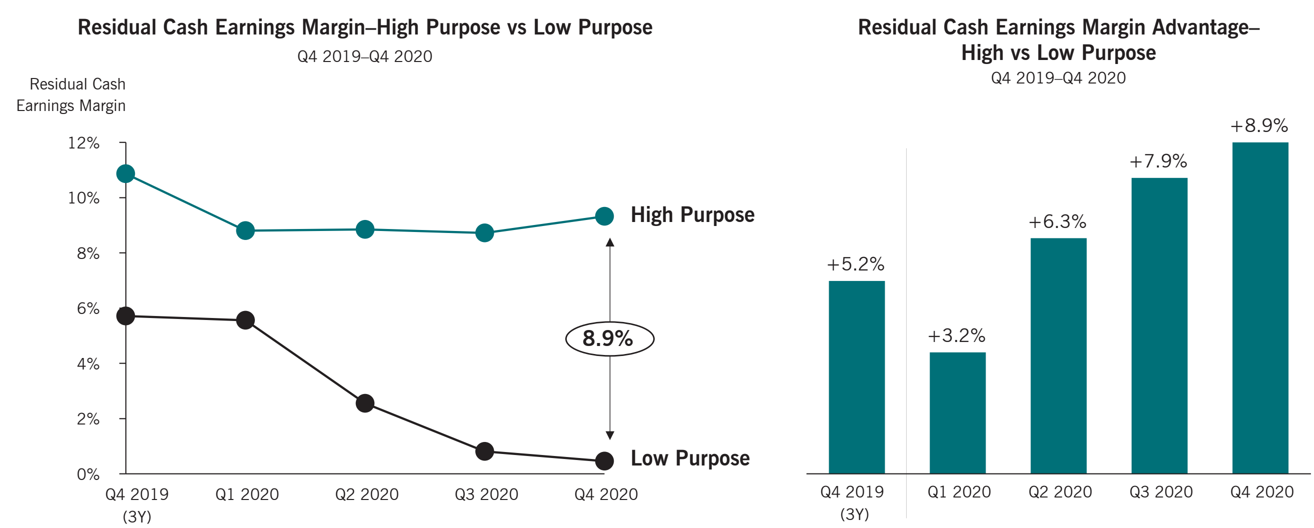


Figure 11

Residual Cash Margin Advantage of High Purpose Companies

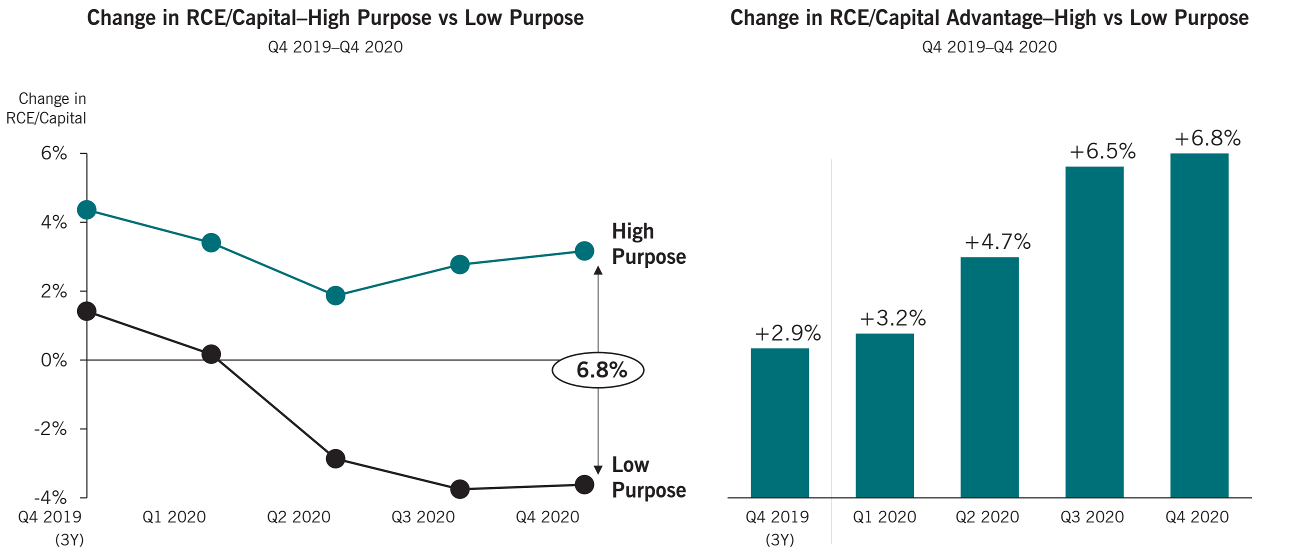


this with a lower Reinvestment Rate than Low Purpose companies—that is, they were actually more conservative investors of available cash than Low Purpose companies. In the three years ending in 2019, High Purpose companies reinvested 57.6% of their Gross Cash Earnings compared to Low Purpose companies that reinvested at a 66.4% Reinvestment Rate. Both High and Low Purpose companies reduced their level of reinvestment during 2020 to preserve cash, but Low Purpose companies were forced to cut back much more significantly—nearly four times more than High Purpose companies. While that's a smart short-term survival strategy, the reduced reinvestment may have limited the ability of Low Purpose companies to recover as quickly as High Purpose companies did during 2020, and we expect that impact may extend into future years.

We also measured the ability to translate reinvestment into revenue growth with our Reinvestment Effectiveness metric. In the three years ending in 2019, High Purpose companies delivered nearly double the Reinvestment Effectiveness, or sales growth per dollar of reinvestment, versus Low

Figure 12

Normalized Residual Cash Earnings Growth Advantage of High Purpose Companies



Capital = beginning operating assets gross of depreciation minus operating liabilities

Purpose companies. Both High and Low Purpose companies saw their Reinvestment Effectiveness decline during 2020, but the decline was marginal for High Purpose companies while Low Purpose companies saw their Reinvestment Effectiveness actually become negative. Purpose-led companies were much more successful at investing their Gross Cash Earnings to deliver and maintain revenue growth before and during the COVID shock.

High Purpose Companies Grow More Intrinsic Value than Low Purpose Companies

Reinvesting effectively generates incremental growth in revenue and Gross Cash Earnings, which creates a flywheel to fund future revenue growth, Gross Cash Earnings, and reinvestment. But growing Gross Cash Earnings is not enough. To create intrinsic value, companies must earn a return on reinvested Gross Cash Earnings that is better than what investors could have earned had that cash instead been returned to them and redeployed elsewhere. This is the basic concept behind economic profit, which we improve upon for management decision-making by looking at it on a cash basis. Like economic profit, we charge for the opportunity cost of capital and subtract that cost from Gross Cash Earnings to get a residual value, or Residual Cash Earnings. As long as the margin of Residual Cash Earnings is positive, intrinsic value has been created per dollar of revenue. And as was shown in "Beyond EVA",[20] the improvement in Residual Cash Earnings relates to TSR better than traditional economic profit in every industry.

High Purpose companies again outperformed Low Purpose companies, generating nearly double the amount of Residual Cash Earnings per dollar of revenue. Over the course of 2020, the Residual Cash Earnings Margin of Low Purpose companies declined materially while margins for High Purpose companies remained stable throughout the year. As a result, the performance gap between the two widened significantly. By year-end, High Purpose companies were generating around 9.5% incremental intrinsic value per dollar of revenue while Low Purpose companies were generating close to zero (Figure 11).[21]

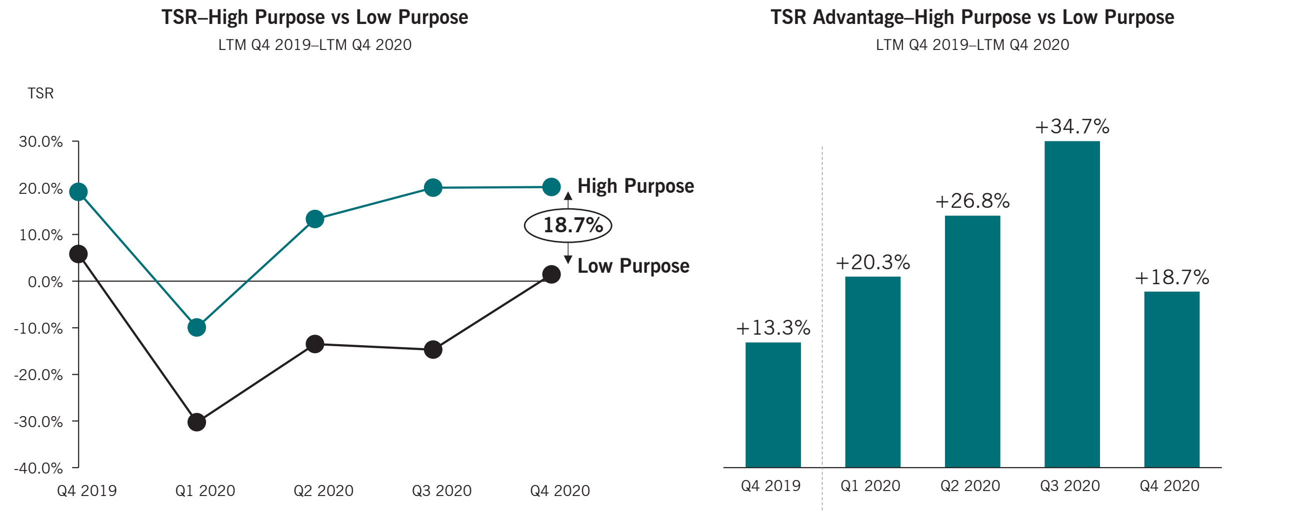
Though Residual Cash Earnings Margin is a very complete measure of profitability and capital productivity, it ignores the value of growth. A more complete measure of value creation is the dollar improvement (or decline) in Residual Cash Earnings. To compare companies of different sizes, we normalize by dividing the change in Residual Cash Earnings by the beginning level of capital.[22]

20 Gregory V. Milano, "Beyond EVA," *Journal of Applied Corporate Finance*, 31(3) 2019, 116-125. https://doi.org/10.1111/jacf.12366.

21 In calculating Residual Cash Earnings Margin, the opportunity cost of capital is measured as the expected return of the S&P 500 given then-current market valuations. Some will have Residual Cash Margins above zero and some below zero, but they will net to zero across the full population. In our smaller sample size, the median of both the High Purpose and Low Purpose companies delivered positive Residual Cash Margin pre-COVID, but post-COVID Low Purpose companies fell close to zero Residual Cash Margin, meaning investors would be indifferent to owning the median Low Purpose company or the S&P Index.

22 We use a metric called Gross Operating Assets to measure capital. We define this

Figure 13
Total Shareholder Return Advantage of High Purpose Companies



Pre-COVID, High Purpose companies grew this metric of intrinsic value creation 2.9% faster than Low Purpose companies.

Post-COVID, as Low Purpose companies suffered strong declines in revenue, their change in Residual Cash Earnings was negative, meaning they were destroying intrinsic value relative to their pre-COVID levels. In Q4 2020 alone, Low Purpose companies destroyed almost 4% of intrinsic value while High Purpose companies actually grew intrinsic value by over 3%.

When a company delivers higher revenue growth and profitability, reinvests its capital more effectively, and requires less capital to do it, it increases its intrinsic value relative to its capital base. What starts as investments in purpose all becomes visible to investors through the financials and is rewarded with higher valuation multiples. It follows from superior financial results and higher valuation multiples that High Purpose companies produce higher Total Shareholder Returns (TSR). During 2019, High Purpose companies delivered median TSR of 19.1% compared to median TSR of 5.8% for Low Purpose companies—a 3.3x difference. Both High and Low Purpose companies saw TSRs fall in Q1 2020, which ended in the midst of the COVID crisis, and both rebounded over the course of 2020. But High Purpose companies rebounded faster and more completely. By Q3 2020, the relative TSR gap between High and Low Purpose companies had grown from 13.3% to 34.7%.

The consistency of our findings across measures of financial performance, market valuation, intrinsic value creation, and total shareholder returns is compelling. Yet there are fair objections to our study, some of which we can address, and some of which require further research. The nascency of studies on purpose and their effects on financial performance mean that alternative assumptions or research design may give conflicting results. Additionally, our dataset measures consumer perceptions of brand purpose—in other words, it is restricted to consumer brand companies. The findings of this research would be further supported by additional studies that rely on measured perceptions of purpose affecting employee, supplier and community relationships in other sectors.

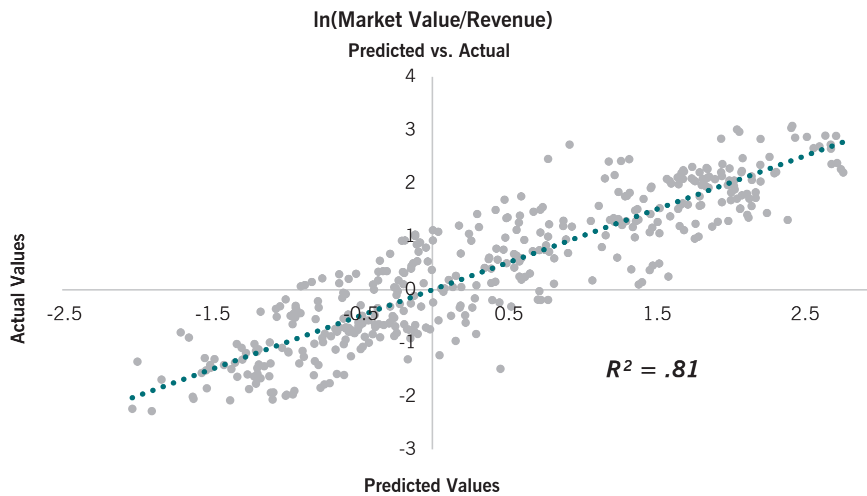
Given the consistent relationship of purpose to outperformance, we considered whether it is possible that perceptions of purpose are the effect or result of outperformance rather than a cause of or contributor to it. In other words, are corporate investments in purpose the reflection of high returns in the core businesses, and are consumers thus finding purpose in companies' success, as opposed to companies finding success through the pursuit of purpose? There may be elements of both, but as we explored earlier, perceptions of purpose change consumer behavior, which directly impacts the financial results and sustainable value creation ability of purpose-led companies.

A second objection comes from the observation that many company statements on purpose may be at odds with their

as operating assets gross of depreciation plus capitalized P&L investments minus operating liabilities.

Figure 14

Actual vs Predicted Market Value/Revenue



**n = 408 (104 companies, 4 quarters each)*

actual business practices. Our dataset relies on consumer perceptions of purpose rather than company statements to provide a measure that is both more objective and more strongly related to the actual consumer behaviors that impact financial results. When company practices diverge from their public statements, we expect this divergence to make its way into consumer perceptions, and thus into this dataset over time.

A third and common objection is that the observed outperformance is primarily attributable to business model advantages, rather than the role of ESG or purpose—as, for instance, in high-margin software businesses with recurring revenue that also score well on purpose. A study that considers financial attributes and purpose as purely independent variables may fail to account for how financial results may depend on purpose. As described above, our research suggests that purpose directly affects financial drivers of company performance and value creation. There are whole battlefields of fallen software companies that believed they had high-margin, recurring-revenue businesses; yet the number that built a sustainable relationship with consumers is far fewer. Even accounting for the successes of the major software business model winners, we still find that purpose has a statistically significant relationship with market values.

Statistical Relationship between Purpose and Market Value

To further test the relationship between purpose and value creation, we developed a regression model using 104 monobrand companies to isolate and identify the contributions of purpose to those companies' market values quite apart from the contributions of conventional financial and operating variables. To do this we selected market value/sales as the dependent variable and included independent variables for financial characteristics such as revenue and financial risk (measured as cash & equivalents divided by the current portion of debt), and for select financial drivers of intrinsic value, including revenue growth,[23] gross cash earnings margin,[24] asset intensity, and both reinvestment rate and reinvestment effectiveness. We also control for select fixed effects using a dummy variable for software companies to account for business model advantages not otherwise captured in the other independent financial variables; and using a dummy variable for hotels, restaurants, and leisure to control for the disproportionate impact of COVID on these industries during our study period. We tested for fixed time effects for the different quarterly periods of our study, but these were not statistically significant.[25]

The results of the regression analysis can be interpreted as follows: each one-unit increase in a company's Purpose score (on a scale of 0 to 100) is associated with a 1.2% improvement in market value (with an R^2 of 0.81). Meaningful investment in purpose can have a measurable improvement in

23 For revenue growth, we use current revenue divided by lagged revenue (t-3).

24 We include a squared transformation of gross cash earnings margin to account for non-linearity at extreme values.

25 The regression model is as follows: ln(Market Cap/Revenue) = β_0+ β_1*ln(Revenue$_{t-3}$) + β_2*ln(Revenuet/Revenuet-3) + β_3*GCE Margin + β_4*GCE Margin$_2$ + β_5*Asset Intensity + β_6*Reinvestment Rate + β_7*Reinvestment Effectiveness + β_8*Financial Risk + β_{10}*Purpose Composite + β_{11}*Software Indicator + β_{12}*Hotels, Restaurants, & Leisure Indicator + ε

market value. For example, a 25-point increase in a company's Purpose score would predict a 35% improvement in a company's market value.[26] To illustrate this, consider the median S&P 500 company, which had revenue of $9.5 billion and a median market value/revenue multiple of 3.2x during the study period. If we assume the median S&P 500 company also had a median Purpose score of 50, and improved that to a top-quartile Purpose score of 75, that median S&P 500 company could expect a 35% improvement of its market value/revenue multiple, or an increase from 3.2x to 4.3x, representing some $10.5 billion in additional shareholder value creation.

The strength of this model is demonstrated in Figure 14: Actual vs predicted market value/revenue, which shows the even distribution around the best fit line, reflecting limited bias at all points. The high R^2 and the strong statistical significance of each independent variable further support the strength of the model (see Figure 15 in the Appendix for additional regression data).

We think this is a conservative assessment of the role of purpose in driving market value, primarily explaining the difference in valuations that reflect expected future performance. Collinearity of purpose with revenue growth and profit margins suggest an impact on current period financial results as well, which is consistent with our findings across metrics in the cohort analysis and review of outside research.

Although our study is limited to a dataset of 104 companies by design, we believe these companies are representative of the role of purpose in driving consumer perception and behavior for the larger universe of 4,000 consumer and B2B brands tracked in the BERA dataset. This kind of analysis can be expanded beyond the branded company universe (e.g., to intermediate industrials or commodity chemicals) with the development of data and attributes specific to stakeholders in those sectors, but each sector relies, or should rely, on the value of the relationship it builds with its consumers, whether those are business or retail consumers. Ultimately, purpose changes the transactional economics between a business and its consumers—those that invest effectively under this paradigm stand to benefit immensely.

Applying our Findings

In both our cohort analysis and statistical analysis we find strong evidence of the relationship between purpose and measures of financial performance, market valuation, intrinsic value creation and total shareholder return. CEOs should be confident that authentic and effective investments in purpose will build both stakeholder value and shareholder value. In fact, far from involving a trade-off with and sacrifice of shareholders' interests, our data suggests that such investments can significantly enhance shareholder value in both the short and long term.

As discussed earlier, CEOs can begin to operationalize purpose by building a stakeholder perspective into decision-making in a variety of ways: finding teachable moments in core business activities, measuring stakeholder impacts, and issuing statements at the board-level endorsing the role of purpose in framing the strategic direction and stance of the company. CEOs and management teams can also take a more analytical approach in considering how best to allocate capital and resources across the firm in pursuit of the company's strategic direction. Investments in purpose build brand equity, which impacts both current financial results and the sustainability of those results into the future. The value of purpose and brand equity in driving sustainability of financial results is often overlooked. Brands lacking strong brand equity will need to spend heavily in advertising and promotion just to maintain prior years' sales. Like a leaky bucket, this hides the ultimately high-capital intensity of maintaining Low Purpose brands. By contrast, High Purpose brands with strong brand equity will better retain consumers over multiple periods, allowing a portion of advertising and promotion, for example, to be reallocated to other areas of investment such as new product innovations, new brand-building campaigns or new markets—all of which improve the scalability of the brand and lead to future value creation.

As we mentioned earlier, each one-point increase in a company's overall purpose score predicts a 1.2% increase in market value for the average company in our study. Achieving this one-point increase means drilling down into the four dimensions of purpose and 13 attributes of purpose shown earlier in Figure 2—each of which relate to financial performance and value creation in a different way for different companies. Companies should consider three stages of action as they consider how best to invest in purpose and allocate resources to deliver their value creation potential:

1. Establish baseline measures across the 13 attributes to identify opportunity gaps relative to near-in peers and the broader brand universe, and quantify how these relate to current financial performance and implied future brand value.

2. Calculate value-at-stake by comparing a baseline valuation reflecting current purpose and financial performance to the potential valuation uplift from improving purpose scores.

3. Prioritize highest value-at-stake opportunities and define action steps, resource needs, and timeline to deliver.

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26 We calculate the 35% improvement as ($e^{(1.2\% * 25)} = 1.35$).

Conclusions

1. Corporate purpose is a dynamic and complex concept with significant implications for chief executives, investors, policy makers, and consumers. We have demonstrated that an authentic corporate purpose, experienced through the brand and lived through the strategy, can help create shareholder value. We also acknowledge the skepticism that the dialogue around corporate purpose generates.

2. Corporate purpose has the potential to create value across stakeholder groups. Nevertheless, we do not see the stakeholder value paradigm as a world free of trade-offs. Quite the opposite; it requires a clear strategic vision and grounded analytical approach to decide who and what to invest in and why.

3. As a result, corporations should continue to demonstrate that they have an authentic purpose, how it was arrived at, how it informs and affects the way the business is managed and overseen, and how the company interacts with key stakeholder groups. As our study suggests (building on the emerging field of analysis of corporate purpose), those corporations that develop and demonstrate a clear corporate purpose are well positioned to realize a return on purpose over the long term and through the uncertainty of crises.

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Appendix

Figure 15

Regression Analysis of Relationship of Purpose to Market Value/Revenue, Controlling for Financial Characteristics, Financial Performance, and Fixed Industry Effects

Dependent Variable: ln(Market Cap/Revenue)

Predictor	Coeff.	Std. Error	t-value	Pr(>|t|)
Constant	-1.088	0.234	-4.64	0.000 ***
ln(Revenue$_{t-3}$)	-0.117	0.022	-5.42	0.000 ***
ln(Revenue$_t$/Revenue Lag$_{t-3}$)	0.368	0.124	2.96	0.003 **
GCE Margin	0.151	0.009	17.74	0.000 ***
GCE Margin (Squared)	-0.002	0.000	-10.88	0.000 ***
Asset Intensity	-0.257	0.051	-5.01	0.000 **
Reinvestment Rate	-0.183	0.052	-3.53	0.000 ***
Reinvestment Effectiveness	0.032	0.015	2.10	0.036 *
Financial Risk	-0.001	0.000	-5.06	0.000 ***
Purpose Composite	0.012	0.002	6.76	0.000 ***
Software	0.574	0.128	4.47	0.000 ***
Hotels, Restaurants, & Leisure	0.262	0.100	2.62	0.009 **

R^2= 0.81

Significance codes: (0 = '***'), (0.001 '**'), (0.01 '*'), (0.05 '.'), (0.1- 1, ' ')

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