Response to “What happened to financially sustainable firms in the corona crisis?”

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Received: 10 July 2020 / Revised: 10 July 2020 / Accepted: 21 July 2020 / Published online: 3 August 2020
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As of this writing, coronavirus continues to pose significant health and economic concerns for almost all the world’s citizenry. Researchers across the globe are searching for insight into the pandemic’s short- and long-term effects on social, economic and environmental challenges—the three pillars of sustainability. This paper seeks to illuminate one piece of the puzzle, i.e., the economic performance of portfolios of firms identified as “financially sustainable” before and during the first three months of the COVID-19 crisis.

The authors identify four conditions for financial sustainability:

1. Income growth rate $\geq$ inflation rate
2. Sufficient probability of survival
3. Acceptable earnings risk
4. Attractive risk-return profile

and apply these screens to a sample of publicly-traded European firms in order to construct portfolios of firms meeting none, one, two, three or all four conditions. (Financial sustainability increases with the number of conditions met). The results, shown in Figs. 1 and 2 of their paper, indicate that firms meeting fewer of these conditions (Score 0) for financial sustainability experienced lower returns vis-à-vis the market portfolio (as proxied by the MSCI Europe Index) than firms meeting all the conditions (Score 4).

I found this paper to be thought-provoking for a number of reasons. First, I was intrigued by the authors’ desire to address the gap between the three-pillar view of sustainability and economic *aka* financial sustainability, an issue of great concern to shareholders and managers. The concept of weak vs. strong sustainability was helpful to me in thinking about the connection between the two. Briefly, strong sustainability avers that natural and human-made capital (including financial wealth) are not perfect substitutes, with

the former having characteristics of irreversibility, uncertainty and criticality (Costanza and Daly 1992; Ekins et al. 2003), while weak sustainability allows for the transformation of one type of capital into another. To the extent that greater economic returns can be translated into greater environmental and social returns, the connection between “financial sustainability” and traditional “three pillar” sustainability appears sound, although Figge (2005) asserts that substitutability of different forms of capital only holds true if there is certainty or if society is risk neutral, and the weak-strong dichotomy is itself subject to criticism (Beckerman 1995).

Second, I was struck by the congruence between the authors’ measure of “sufficient probability of survival”—the second of their four conditions for financial sustainability—and similar measures used to evaluate the resilience of natural plant and animal populations. The equation put forth by the authors includes estimates of firms’ return on capital employed (ROCE) and equity ratio (ER), arguing that companies with more profitable opportunities (higher ROCE) and larger equity positions are better positioned to bounce back from adverse events. Ecologists have long recognized that high reproductive rates (akin to ROCEs) confer survival benefits for organisms in unstable or unpredictable environments and that a minimum viable population (MVP)—the minimum number of breeding individuals needed to ensure survival of a given population unit in both the short and long term—is also relevant (Whitaker and Fernandez-Palacios 2007). Financial managers describe the latter concept using the language of “burn rates,” “borrowing capacity,” “rainy day funds,” and “equity cushion” (often expressed as the equity ratio), but the idea is essentially the same. Thus, I thought this contribution holds promise for bridging some of the intellectual and communication gaps between the economic and ecological disciplines, at least with respect to discussions about resilience.

My last observations are really requests for an encore performance, recognizing that this paper is one of the earliest to investigate the impacts of the COVID-19 crisis,

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Fig. 1 Development of Indexed Portfolios, July 2019 to July 2020. This figure does not necessarily reflect reality; the MKT returns accurately present the MSCI Europe index since March 2020, but the Score 0 and Score 4 portfolio returns are hypothetical

and appreciative of both its swift analysis and publication. Specifically, I have two asks:

- a) The construction method for Score 0 to Score 4 portfolios gives equal weight to each condition of financial sustainability. I would be curious to learn if any of these conditions are more important than the others with respect to differences in financial performance shown in Fig. 1. A related issue would be to test each portfolio against one another, perhaps using an ANOVA analysis, to determine the impact of the various financial sustainability factors. Put another way, are all four factors required to establish financial resilience?
- b) And finally, it would be awesome to see how things stand *now*, i.e., in July 2020. The markets as a whole have recovered somewhat, and ideally, one would hope to see performance similar to what's shown in Fig. 1, i.e., that Score 4 portfolios “bounce back” more quickly than either the benchmark or Score 0 portfolios. There would still be questions of behavior over the long haul, but given the argument being put forth that the concept

of financial sustainability confers both performance and resilience benefits, this would be a wonderful reprise to the authors' original contribution!

Conflict of interest M. A. White declares that he has no competing interests.

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