Environmental, Social, and Governance

From Shareholders to Stakeholders

By Joe Tarantino

Earlier this year, Laurence D. Fink, the founder, chair, and CEO of BlackRock, issued an open letter to CEOs. In it, Fink called on companies to develop a larger sense of purpose, and cited several challenges: wages barely covering living costs, rising higher education costs, a crumbling traditional retirement model, the critical need for worker retraining to adjust to an increasingly automated world, the failure of the public sector to prepare for the future, and the rise of activism and wasteful proxy battles.

These dynamics necessitate that companies serve a social purpose, meaning they must deliver financial performance as well as show how they are making a positive contribution to society. The consequence of ignoring this clarion call can mean a company's failure to "achieve its full potential … [and] ultimately [lose its] license to operate from key stakeholders."

Forbes hailed the letter as a "watershed event." As asset managers communicate similar messages to corporate boards and CEOs, they signal that their line of sight is on sustaining long-term growth rather than just current profits.

Fink points to the increasing popularity of index funds. For actively managed funds, asset managers are in a position to sell a company's stock if they have reservations about its strategic direction or long-term growth prospects. Investors cannot, however, sell stock in cases where the company is a component of the index fund.

As a result, Fink states that "our responsibility to engage and vote is more important than ever." To that end, BlackRock plans to double the size of its investment stewardship team over the next three years.

The letter reiterates BlackRock's past requests that companies publicly disclose their strategic framework for long-term value creation and explicitly affirm that the framework has been reviewed by the board. The board must be engaged with the strategic direction of the company through an effective process for overseeing the strategy. Fink asserts that a sense of purpose is key to managing activism.

My experience in working with our clients and their boards is that these points are vital to sustaining the success of any company. In the *2017–2018 NACD Public Company Governance Survey*, directors ranked the most important areas of improvement for their boards over the next 12 months. The top three are understanding the risks and opportunities affecting performance, monitoring strategy execution, and contributing to strategy development. These improvement opportunities offer pause for reflection in considering stronger board engagement.

Fink also points to the importance of diverse boards in a complex world, asserting that they are less susceptible to groupthink or missing emerging business model threats and more likely to identify long-term growth opportunities. Together, takeaways from NACD's survey and Fink's call for diversity ought to be considered by every board in executive session.

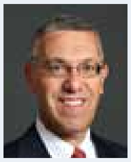
Accountability for delivering acceptable financial results will never fall by the wayside in our lifetimes. But the BlackRock letter asserts that long-term sustainable results are not possible if the focus is limited to financial performance. The gist is that a shift from a shareholder model to a stakeholder model is needed as companies focus on a broader range of issues affecting their employees, customers, and the communities in which they operate, in addition to their ongoing focus on shareholders.

In the changing optics of our times, companies that can demonstrate solid performance on the environmental, social, and governance (ESG) fronts along with the financial side are more likely to sustain success over the next decade than those that do not. Fink calls to integrate these issues in driving strategy, investment, and performance, and that is exactly what BlackRock intends to do in its investment process.

Nearly 120 years ago, John Pierpoint Morgan, when asked by a reporter about his role in causing a stock market panic, famously said, "I owe the public nothing." It is unlikely that anyone would say that today.

In our highly interconnected world, CEOs face the daunting challenge of delivering more than profits. Strong corporate leadership is needed to balance short-term earnings pressures with the need to invest in employee development, innovation, and capital expenditures to grow over the long term. Meanwhile, the concept of selective investing using ESG criteria is evolving, influencing how asset managers and long-term investors analyze investment alternatives and manage investment portfolios.

To be sure, this is not easy. But the world is changing.



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