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The currency of capitalism with a social conscience

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BY

Daniel E. Barenbaum and A. Chowning Poppler

Berman Tabacco

When attendees of the World Economic Forum gathered in Davos, Switzerland for its annual meeting, the topic of conversation was 'Larry's letter'. The week before the Forum, Larry Fink, founder and chief executive of the $6.3 trillion asset manager BlackRock, circulated a letter to CEOs of the largest public companies across the globe requesting that they commit to sustainable growth. Mr Fink was not merely requesting a pledge to financial growth, he was asking companies to articulate long-term plans to contribute to the betterment of society. His letter declared: "Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate."

The letter went on to explain how BlackRock will hold companies to these ideals. In its actively managed funds, with $1.7 trillion of investable assets, BlackRock could sell a company's securities if the fund manager is doubtful about that company's strategic direction or prospects for long-term growth. In its passively-managed index funds, BlackRock will actively engage with companies to ensure that they are focused on building long-term value. BlackRock envisions companies publicly articulating a strategic framework to achieve financial performance that acknowledges the societal impact that the

business has on broad trends from wage growth, to automation and climate change.

As the largest investor in the world, BlackRock has considerable influence on public companies' boards, and it has a vision of what those boards should look like. Mr Fink emphasised the importance of having boards that are comprised of a diverse mix of genders, ethnicities, career experiences and ways of thinking.

BlackRock is not alone in advocating for long-term investment in the greater good. Vanguard chairman Bill McNabb, together with the heads of nine other asset managers, recently wrote to CEOs and urged them to move beyond quarterly earnings calls and focus on long-term growth plans that should account for "key risk factors and mega trends (such as climate change)" and how best to manage "human capital". Mr McNabb would like businesses to broaden their horizons. "For far too long, companies have sacrificed long-term value creation to generate short-term results," he notes.

This trend is known as 'conscious' or 'socially-responsible' capitalism. The basic concept is that businesses have multiple stakeholders — not just owners, but employees, consumers and the community — and each of their interests should be considered in setting the long-term goals of the company. In recent years, this trend has manifested through investors' concerns around climate change.

Institutional investors are exploring socially-responsible capitalism through, for example, their investments in, and engagement with, fossil fuel companies. This pursuit requires institutional investors to not only maximise profits as a fiduciary, but also to make thoughtful decisions about the nature of the businesses that they invest in and whether those companies are negatively impacting the environment.

Over the past several years, a small but growing number of pension funds around the world have decided to fully or partially divest from companies that generate revenues from oil, gas and coal. In January 2018, New York City's public pension fund announced it would divest its fossil fuel holdings over the next five years. In November 2017, Europe's top oil producer, Norway, proposed selling off its fossil fuel investments from its trillion-dollar sovereign wealth fund (a fund that was created through sales of fossil fuels).

The financial rationale for divestment is that as governments address climate change, carbon-intensive businesses are primed to suffer financial losses. And there is some data indicating that these stocks are underperforming. For example, in 2017, the data provider MSCI reported that, for the period between November 2010 and May 2016, two of its indices that excluded coal and fossil fuel companies outperformed parent indices that included them.

But there is also contrary data, making divesting in fossil fuel companies to achieve best financial returns controversial. Some academics and investment experts argue that prematurely exiting the industry could leave future returns unrealised. A finance

professor at Arizona State University conducted a study in 2016 that indicated that university funds that pulled out of fossil fuels would lose between 2 and 12 percent of their endowment value over a 20-year period.

In addition to financial results, there is a debate about whether divestment is the most effective means to ensure that companies maintain environmentally-friendly operations. In 2017, the University of Cambridge ruled out divesting its endowment fund from oil & gas, arguing that it was more effective to engage with fossil fuel companies in order to hold them accountable. In 2017, BlackRock, Vanguard and a coalition of investors did just that by supporting a shareholder proposal to enhance ExxonMobil's climate disclosures. As a result, in December 2017, ExxonMobil agreed to publish climate impact reports and changed its policy of non-engagement that had prevented independent board members from meeting with shareholders. Other investors believe a combined strategy of divestment and engagement is the most effective means of maximising returns while driving change. Time and data will tell which methods prove to be most impactful.

Back in the Swiss Alps, many lauded 'Larry's letter' as a bold statement embodying the future of capitalism. Executives boasted of their corporate social responsibility departments, and there was talk of impact investing. Others wondered if fiduciary duties, financial performance and maximising shareholder value could be reconciled with decisions driven by a desire to make positive contributions to society. And critics voiced their concerns that BlackRock was overreaching by imploring CEOs to ensure that their businesses are beneficial to society at large.

The debate is ongoing as boards, executives and asset managers continue to define what a sustainable business looks like in the 21st century and determine whether companies can afford to bridge the gap between their own apparent self-interest and the broader needs of society. But make no mistake, with industry goliaths such as Blackrock and Vanguard staking out the high ground, the debate has turned a significant corner. And society is the better for it.

Daniel E. Barenbaum is a partner and A. Chowning Poppler is an associate at Berman Tabacco. Mr Barenbaum can be contacted on +1 (415) 433 3200 ext. 2325 or by email: dbarenbaum@bermantabacco.com. Ms Poppler can be contacted on +1 (415) 433 3200 ext. 2348 or by email: cpoppler@bermantabacco.com.

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