

# MORROW SODALI



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## A COMMON-SENSE APPROACH TO CORPORATE PURPOSE, ESG AND SUSTAINABILITY

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With publication of the Business Roundtable’s “Statement on the Purpose of a Corporation,”<sup>[1]</sup> America’s top business and financial leaders now officially support the rapidly evolving ESG/sustainability movement, confirming that environmental, social and corporate governance policies are inextricably linked to business risk, value creation, financial performance and sustainability.<sup>[2]</sup>

The global push for sustainability has already proven to be a game changer that is altering the behavior of both institutional investors and companies. While investors struggle with the challenge of integrating ESG factors into their investment decisions, companies willing to define a meaningful corporate purpose and exploit the full potential of sustainability reporting can achieve important goals:

- Do a more effective job managing relations with institutional investors and shareholders;
- Reshape corporate reporting to provide a holistic picture of the business and its value drivers;
- Direct shareholders’ attention to the company’s unique characteristics and values;
- Designate company-specific performance metrics linked to business strategy and value creation;
- Reduce investors’ reliance on external one-size-fits-all standards and inappropriate metrics;
- Reduce vulnerability to shareholder activism.

The key to achieving these goals is suggested in the central concept at the heart of the BRT Statement: “*While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders.*”

What is noteworthy here is the BRT’s assertion that each company “*serves its own corporate purpose.*” In effect, each company is the master of its own fate in determining how to tell its ESG/sustainability story, how to deal with its stakeholders and how ultimately to define its purpose and achieve sustainability.

The BRT lists stakeholders in the order of “customers” first, followed by “employees,” “suppliers,” “communities” and finally “shareholders.” This sequence does not alter the longstanding presumption that shareholders occupy the position of first among equals. As equity owners and providers of capital, shareholders have always required a high and continuous level of attention from companies. Voting power gives shareholders a direct voice in corporate governance; their investment decisions determine a company’s stock price and cost of capital. Accordingly, shareholders remain the primary audience for a company’s sustainability story. It is also important to remember that a company’s creditors, specifically investors in its fixed income securities, rank with shareholders at the top of the stakeholder list.

## FIVE INITIAL QUESTIONS ABOUT PURPOSE AND SUSTAINABILITY REPORTING

Corporate purpose, ESG integration and sustainability reporting present companies with new questions and challenges.

### 1. Should U.S. companies be wary because publication of the BRT Statement has been met by expressions of criticism and mistrust?

In the words of Nell Minow: “[The BRT Statement] does not really mean anything... We are waiting to see CEOs put their money where their mouths are.”<sup>[3]</sup> In our view, the intentions of the BRT and the signatory CEOs are less important than the ideas in the Statement. Companies are free to take the ideas at face value and determine for themselves whether or how corporate purpose can benefit stakeholders and accomplish the goals listed above. Even more important, the largest institutional investors, led by BlackRock Chairman and CEO Larry Fink, believe that corporate purpose is inextricably linked to profit. In his 2019 letter to CEOs Mr. Fink said: “... every company needs a framework to navigate this difficult landscape, and ... it must begin with a clear embodiment of your company’s purpose in your business model and corporate strategy. Purpose is not a mere tagline or marketing campaign; it is a company’s fundamental reason for being – what it does every day to create value for its stakeholders. Purpose is not the sole pursuit of profits but the animating force for achieving them.”<sup>[4]</sup>

### 2. How should companies deal with the confusing jumble of terminology that has grown up around the sustainability movement?

There has been little consistency in the use of terms such as ESG, CSR (Corporate Social Responsibility), climate change, intangibles, culture, character, purpose, long-term focus, non-financial performance metrics, etc. Even the umbrella terms “corporate purpose” and “sustainability” can take on different meanings in the context of different companies, industries and countries. In our view, each company should assume responsibility for selecting and defining the terminology that works best for describing its purpose, business circumstances, strategy, value drivers and goals and that reflects the sustainability issues that are most important to its investors.

### 3. How should companies deal with the maze of different sustainability metrics and standard-setters?

Here again, in dealing with the crowd of different raters and ratings, particularly those focused on climate change, each company is presumed to be the best judge of the metrics and standards that are appropriate for its business. Many companies around the world are looking to SASB (Sustainability Accounting Standards Board) as the starting point and guide for determining the materiality of specific sustainability issues. The next step is to select one or more standard-setters – UNPRI, UNSDGs, CDSB, TCFD, CDP, CDSP, GRI, etc. – as deemed appropriate based on industry coverage, use by peers, investor feedback and other factors. To add to the complexity, there is an additional layer of sustainability raters that serve institutional investors. These include the two global proxy advisory firms ISS and Glass Lewis, which now include sustainability evaluations in their proxy

voting recommendations. In addition, there are independent firms such as MSCI, IRIS, Trucost and others. This category of raters that serve investors is primarily important to companies in the context of their annual meetings and proxy solicitation campaigns.

#### 4. How should sustainability reporting fit into a company's legal disclosure obligations?

For U.S. companies in particular there is a nagging concern about the relationship between voluntary disclosures made in a sustainability report and mandated disclosures in the Form 10K annual report. Two prominent U.S. companies have dealt with this question in different ways, producing reports based on contrasting models of integrated reporting. **Intel Corp.** covers ESG and sustainability within a comprehensively redesigned 10K annual report. **Travelers Corp.** has left the traditional 10K intact and produced a separate integrated sustainability report that exports material ESG information from the 10K so as to provide a comprehensive picture of the company's business organized around its five drivers of sustained value. Recent webcasts sponsored by the U.S. Community of the IIRC (International Integrated Reporting Council) describe in detail the different approaches taken by Intel and Travelers. They can be found here: [Intel](#), [Travelers](#). We strongly recommend these informative presentations as outstanding examples of innovative thinking and excellence in sustainability reporting, integrated reporting, investor relations and shareholder communications.

#### 5. Does customized sustainability reporting undermine comparability in the marketplace?

Financial disclosure, underpinned by accounting standards, has provided the basis for investors to compare the performance of individual companies with peers and to establish relative market value and stock price across different industries and jurisdictions. Corporate governance also achieves comparability through a set of external standards applicable to companies globally, with allowance for voluntary "comply-or-explain" and "apply-or-explain" variations. The introduction of Environmental and Social considerations adds a new layer of complexity and raises two initial questions: (i) Is E and S comparability more important for companies, or for investors? (ii) Who is responsible for establishing E and S comparability – companies, investors, auditors, NGOs, or regulators? The answer to the first question is clear: comparability is equally important for both. The answer to the second question is far from clear. For the moment, NGOs and standard-setters, together with institutional investors, are taking the lead. Companies have a wide range of choices among raters, particularly those dealing with climate change. Proxy advisory firms are also grading E and S as well as G. SASB standards are viewed as a starting point, but, as SASB admits, *"Ultimately, companies decide what is financially material and what information should be disclosed, taking legal requirements into account."* SASB's statement mirrors the BRT's assertion that *"each of our companies serves its own corporate purpose."* The issue of comparability will take time to be resolved. For now, we are in a shake-out period in which companies are advised to adopt standards that work best for their business while at the same time engaging directly with their institutional investors to determine which metrics and standards are most meaningful to them. Through collaboration, companies and investors together with NGO standard setters should strive to find a private sector solution to comparability without the need for regulation.



## SUGGESTIONS FOR COMPANIES

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The corporate purpose/ESG/sustainability movement is simultaneously altering the behavior of both companies and investors. With investors working to integrate sustainability issues into their investment decisions as well as their stewardship duties and proxy voting policies, companies are seeking to respond by defining their purpose and integrating ESG and sustainability issues into their financial reporting, shareholder communications, investor relations, board engagement and proxy solicitation campaigns. This requires companies to take a holistic approach that can present organizational challenges for which there is no one-size-fits-all solution. The following approaches should be considered:

### A. Publish a Statement of Corporate Purpose.

Governance experts and academics are already providing templates, but the challenge for each company is to produce a Statement of Purpose uniquely suited to its business strategy, stakeholders and sustainability goals.

### B. Take a hard look at the content of corporate reporting.

Both Intel and Travelers developed their own distinct ways of telling the company's story holistically through the eyes of management by describing their sources of capital, their value drivers and their strategy for achieving sustainability. From these and other examples of integrated reporting companies can get ideas for different ways to provide an inside perspective on their business and tell their story. Corporate reporting should be directly responsive to investors' demand for sustainability metrics and forward-looking information. Engagement practices that companies have developed around compensation serve as a model for sustainability reporting.

### C. Take a holistic approach to shareholder communications.

Traditional corporate communications activities are designed to reach different audiences and are administered by different corporate functions -- investor relations programs, governance road shows, CSR reporting, board engagement campaigns, shareholder relations, proxy solicitation, strategic communications, etc. Sustainability reporting requires a holistic approach. This can be accomplished in different ways, depending on a company's internal structure and resources. One example of effective integrated communication is the "Communications Clearinghouse,"<sup>[5]</sup> in which the IR executive serves as the coordinator of content delivered from the CFO, CSR team, corporate secretary, governance executive, Human Resources, board of directors (particularly compensation and governance committees) and the CEO in strategic contingencies, in order to deliver an integrated message that defines corporate purpose and addresses the interests of all stakeholders.

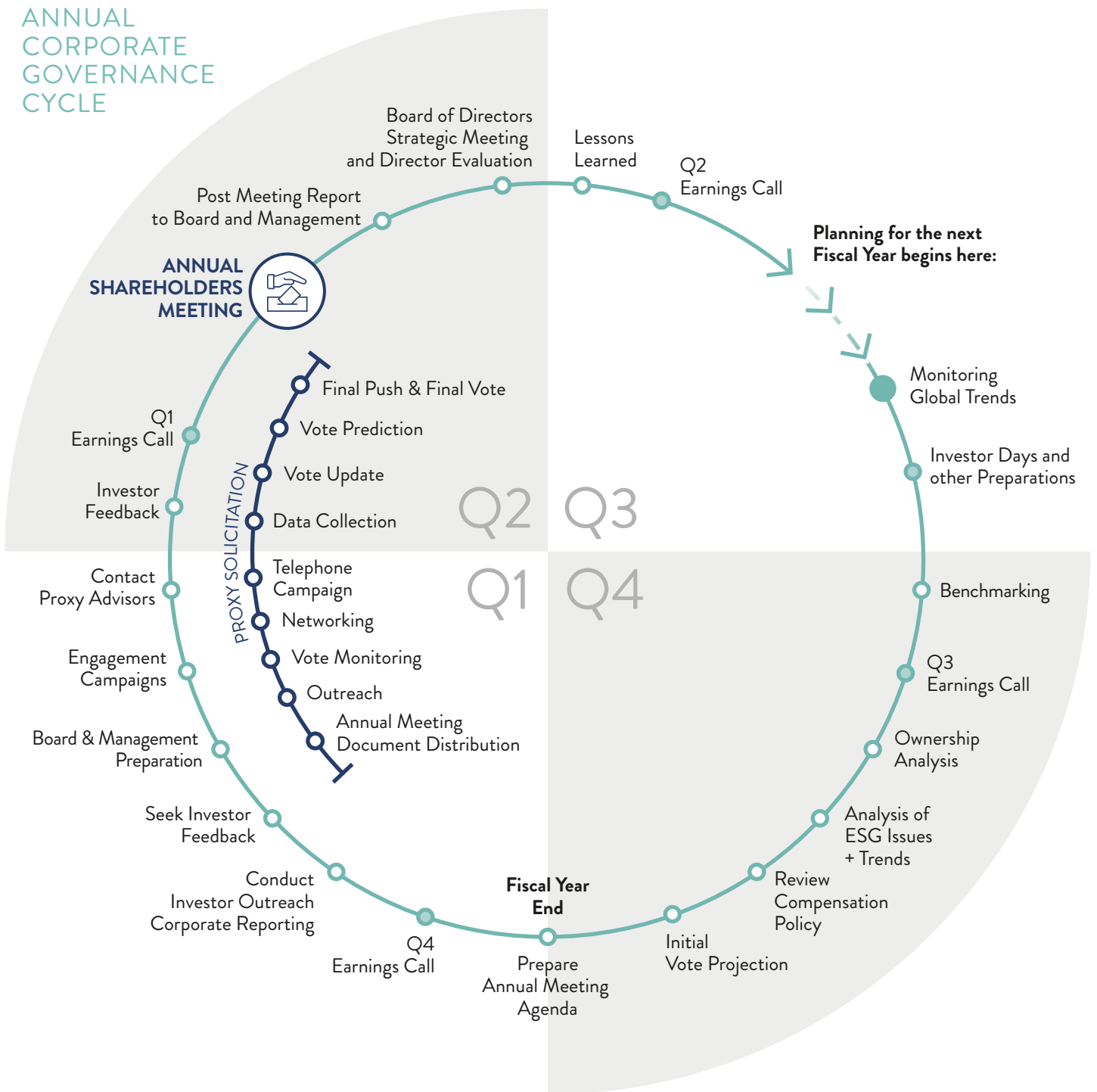
### D. Organize a systematic, annualized approach to shareholder relations and communication.

Every publicly-traded company's fiscal year gives rise to a fixed annualized cycle of ESG obligations. The annual shareholder meeting and quarterly financial reports are key investor relations points on this annual corporate compass. Companies can map their annual obligations and build around them a plan to manage relations with shareholders that includes corporate purpose, ESG policies and sustainability goals, as well as IT activities and financial reporting. The ESG mapping steps include the following activities:

- identify shareholders and create an ownership profile;
- analyze the implications of that profile;
- monitor trading and market activity;
- collect and analyze data relating to shareholders' ESG policies and voting decisions;
- identify material ESG risks and opportunities;
- assess vulnerability to activism;
- prepare predictive vote projections;
- fine-tune proposals on the annual meeting agenda to strengthen shareholder support;
- organize ESG engagement and road shows;
- plan and conduct an effective proxy solicitation campaign and vote tabulation;
- review voting results and lessons learned;
- educate the board of directors about ESG issues;
- provide data and insights for ESG benchmarking and board evaluation;
- prepare for ad hoc initiatives such as mergers and other corporate actions;
- deal effectively with special situations such as takeovers and proxy contests;
- establish a relationship of trust with key owners and investors that will reduce vulnerability to activism and strengthen defense against it.



ANNUAL CORPORATE GOVERNANCE CYCLE



Companies can achieve a number of important goals through this systematic, step-by-step approach to investor/shareholder relations: (i) they can understand the granular details of ESG criteria being used by investors' stewardship teams; (ii) they can benchmark their own ESG practices against these criteria, which may vary from investor to investor; (iii) they can predict how investors' voting policies will be applied to them and then make plans to avoid dissent and strengthen support; (iv) they can determine whether or how to qualify for inclusion in new ESG-oriented sustainable funds being created by asset managers in response to growing investor demand.

## CONCLUSION

Something new, something old.

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Andrew Ross Sorkin's commentary in the New York Times on August 20, 2019 added an interesting perspective on the BRT Statement. He said, "...what we may be at the start of is less a new era and more a return to the past... [when] corporations, for the most part, were run for all stakeholders."<sup>[6]</sup> Many in the corporate community who remember the post-WWII corporate era are likely to agree, but only partially. One fundamental change resulting from decades of corporate governance reform is that the role, responsibilities and accountability of the board of directors have been permanently amplified. Corporate boards will never return to the days where they operated in the shadows with their primary responsibility being to provide advice to the CEO as needed. Sorkin may be right in harkening back to the role of the CEO as "business statesman" exemplified by venerated figures such as former GE CEO Reginald Jones. For Jones the role of CEO was exemplified by the weight and scope of his responsibilities that included all stakeholders, communities and the global economic impact of the enterprise. This approach fell out of favor with the ascension of Jones's successor Jack Welch, who exemplified the "imperial CEO" in the era of shareholder primacy. It remains to be seen whether the broader focus on stakeholders and sustainability will produce a new generation of millennial CEOs in the mold of Reginald Jones. The BRT's decision to appoint as its next Chairman Walmart CEO Doug McMillon, characterized by the media as a "new-age CEO," suggests that the BRT is stepping up to Nell Minow's challenge.

As this discussion reveals, the state of affairs with respect to corporate purpose, ESG and sustainability is unsettled. Both companies and institutional investors are grappling with changing expectations in an atmosphere of intense public scrutiny and political pressure. Over the long term the success and impact of the ESG movement will hinge on both shareholders and companies doing their part. Investors must apply more resources to evaluate ESG issues on a company-specific basis, develop deeper expertise on specific industry and corporate risks and value drivers and push third-party ratings and advisory firms to develop more substantive and insightful methods of assessment. Looking ahead to 2020 and beyond, companies should continue to search for the most effective way to tell their story and work to bring their shareholders and stakeholders into the embrace of the corporate family.

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## NOTES

- [1] The Business Roundtable is a business association whose members are exclusively the CEOs of America's largest companies.
- [2] It is beyond the scope of this paper to discuss the reasons for the rapid rise of the global ESG movement or the reasons for the consensus among companies and investors that ESG factors are inextricably linked to corporate financial performance. In recent years there have been many research studies on this topic. See, for example:
- <https://www.spglobal.com/en/research-insights/articles/the-esg-advantage-exploring-links-to-corporate-financial-performance>
- <https://www.robeco.com/en/insights/2019/01/the-link-between-esg-and-performance.html>
- <https://www.mckinsey.com/business-functions/sustainability/our-insights/more-than-values-the-value-based-sustainability-reporting-that-investors-want>
- [3] <https://corpgov.law.harvard.edu/2019/09/02/six-reasons-we-dont-trust-the-new-stakeholder-promise-from-the-business-roundtable/>
- [4] <https://www.blackrock.com/hk/en/insights/larry-fink-ceo-letter>
- [5] <http://www.morrowsodali.com/insights/investor-relations-a-communications-clearinghouse>
- [6] <https://www.nytimes.com/2019/08/20/business/dealbook/business-roundtable-corporate-responsibility.html>

## A NOTE ABOUT MORROW SODALI

Changes that affect our clients also affect Morrow Sodali. We must be alert to changing market conditions and adapt our services to ensure that we continue to provide maximum value to clients. Action steps we have already taken to help clients respond to the challenges of ESG, sustainability and stakeholder governance include the following:

- deepening our expertise in trends and strategies relating to ESG and sustainability;
- expanding our global branch office network;
- constructing a global platform of proprietary data relating to investors' ESG policies, engagement and proxy voting;
- organizing our transactional services, data collection, market intelligence and strategic advisory services into an integrated package aligned with clients' annual corporate cycle;
- accessing new digital technology to reach retail shareholders, millennials and Generation X digital investors;
- developing additional strategic counseling and reports for boards of directors;
- strengthening the relationship of trust with institutional investors that has been a distinguishing feature of our business model for more than a decade.

These actions are necessary for us to fulfill Morrow Sodali's goal of providing clients with a single-source solution to the ownership and market challenges they face because they are publicly traded.

## ABOUT MORROW SODALI

Morrow Sodali is a leading provider of strategic advice and shareholder services to corporate clients around the world. The firm provides corporate boards and executives with strategic advice and services relating to corporate governance, shareholder and bondholder communication and engagement, capital markets intelligence, proxy solicitation, shareholder activism and mergers and acquisitions.

From headquarters in New York and London, and offices and partners in major capital markets, Morrow Sodali serves more than 700 corporate clients in 40 countries, including many of the world's largest multinational corporations. In addition to listed and private companies, its clients include mutual funds, ETFs, stock exchanges and membership associations.

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