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Corporate Purpose: ESG, CSR, PRI and Sustainable Long-Term Investment

In *The New Paradigm* for corporate governance and investor stewardship, I, together with a Wachtell Lipton team, created for the International Business Council of the World Economic Forum, deliberately conflated ESG (environmental, social and governance), CSR (corporate social responsibility), PRI (the UN's principles for responsible investment) and sustainability because they are all essential elements of long-term investment strategies designed to create increasing profits and value for shareholders.

Now, the April 23rd Department of Labor Field Assistance Bulletin No. 2018-01 has raised questions about the role of ESG factors in investment. Some have read it as foreclosing ERISA investors from promoting ESG on the assumption that it is at the expense of profits and shareholder value. Others have argued that that is an extreme interpretation. As set forth in our April 27 note on the DOL bulletin, there is no need for the debate when it is recognized that ESG, CSR and PRI are essential factors in sustainable long-term investment to create growing shareholder value. If the purpose of a corporation does not include ESG, CSR and PRI, it is unlikely that it will be able to create the sustainable long-term growth being sought by the people for whom the investors are acting. This was made clear in Larry Fink's 2018 letter to CEOs:

> Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only

> the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.

The question of purpose of the corporation has been long debated and in recent years has become the subject of intense academic discussion and proposed and enacted regulation.

The Dutch Corporate Governance Code, issued December 8, 2016, expressed purpose as the duty of the management board:

> The management board should develop a view on long-term value creation by the company and its affiliated enterprise and should formulate a strategy in line with this. Depending on market dynamics, it may be necessary to make short-term adjustments to the strategy.
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> When developing the strategy, attention should in any event be paid to the following:
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> i. the strategy's implementation and feasibility;
> ii. the business model applied by the company and the market in which the company and its affiliated enterprise operate;
> iii. opportunities and risks for the company;
> iv. the company's operational and financial goals and their impact on its future position in relevant markets;
> v. the interests of the stakeholders; and
> vi. any other aspects relevant to the company and its affiliated enterprise, such as the environment, social and employee-related matters, the chain within which the enterprise operates, respect for human rights, and fighting corruption and bribery.

In March of this year, a report of a commission appointed by the French Government recommended amendment to the French Civil Code to add, "The company shall be managed in its own interest, considering the social and environmental consequences of its activity," following the existing, "All companies shall have a lawful purpose and be incorporated in the common interest of the shareholders." The draft amendment is intended to establish the principle that each company should pursue its own interests—namely, the continuity of its operation, sustainability through investment, collective creation and innovation. The report notes that this amendment integrates corporate and social responsibility considerations into corporate governance and goes on to state that each company has a purpose not reducible to profit and needs to be aware of its purpose. The report recommends an amendment to the French Commercial Code for the purpose of entrusting boards of directors to define a company's purpose in order to guide the company's strategy, taking into account its social and environmental consequences.

Also, in March, the European Commission in its *Action Plan: Financing Sustainable Growth* proposed both corporate governance and investor stewardship requirements:

> Subject to the outcome of its impact assessment, the Commission will table a legislative proposal to clarify institutional investors' and asset managers' duties in relation to sustainability considerations by Q2 2018. The proposal will aim to (i) explicitly require institutional investors and asset managers to integrate sustainability considerations in the investment decision-making process and (ii) increase transparency towards end-investors on how they integrate such sustainability factors in their investment decisions in particular as concerns their exposure to sustainability risks.

Further, the European Commission proposes a number of other laws or regulations designed to promote ESG, CSR and sustainable long-term investment.

While I agree with the legislative and regulatory proposals to establish the purpose of the corporation, I would prefer that they not be necessary. Such measures are often accompanied by, or soon beget, restrictions on corporate management that limit flexibility and profitability. Instead, I prefer and recommend what I proposed in *The New Paradigm*:

> *The New Paradigm* is an emerging corporate governance framework that derives from the recognition by corporations, their CEOs and boards of directors, and by leading institutional investors and asset managers ("investors"), that short-termism and attacks by short-term financial activists significantly impede long-term economic prosperity. The economic impact of a short-term myopic approach to managing and investing in businesses has become abundantly clear and has been generating rising levels of concern across a broad spectrum of stakeholders, including corporations, investors, policymakers and academics. The proposition that short-term financial activists and reactive corporate behavior spur sustainable improvements in corporate performance, and thereby systemically increase rather than undermine long-term economic prosperity and social welfare, has been overwhelmingly disproved by the real world experience of corporate decision-makers as well as a growing body of academic research. This emerging consensus has reached a tipping point, and decisive action is imperative. *The New Paradigm* is premised on the idea that corporations and institutional investors can forge a meaningful and successful private-sector solution, which may preempt a new wave of legislation and regulation.

Martin Lipton