Advancing Purpose

How purposeful companies and investors can make better common cause

Executive summary report

23 February 2023

The Purposeful Company was launched in 2015. A consortium of leading FTSE companies, investment houses, business schools, business consultancy firms and policy makers, it has been examining how the governance and capital markets environment in the UK could be enhanced to support the development of value generating companies, acting with purpose to the long-term benefit of all stakeholders.

The Steering Group, co-chaired by Clare Chapman and Will Hutton, oversees its work. Members of the Steering Group act in their personal capacity, and their views may not be taken to represent the views of their organisation. Equally the conclusions and recommendations that the Steering Group draws from its work, this report included, are ours and not every specific proposal or comment should be taken to represent the views of each of our interviewees or our task force members, although they do support our overarching principles and aims.

Steering Group

Clare Chapman, Non-Executive Director and Acas Chair (Advisory, Conciliation and Arbitration Service)
Alex Edmans, London Business School
Will Hutton, President of the Academy of Social Sciences and LSE
Colin Mayer, Blavatnik School of Government Oxford University

Thanks to Tom Gosling, Advisor to the Steering Group for his ongoing engagement and to Philippe Schneider for additional detailed research.

To see the full Advancing Purpose report: www.thepurposefulcompany.org/reports

The Interviewees *and their purpose statements*

ACAS Chair Clare Chapman
"Our purpose is to make working life better for everyone in Britain. Employers often come to us at their most difficult moments and employees at their lowest ebb. We lead the way in promoting good work and reducing disputes".

Academy of Social Sciences President Will Hutton
"We exist to promote social sciences in the UK for public benefit. We showcase, champion and advocate for the social sciences, raising awareness of their immense value and helping to secure their flourishing future".

Aviva, CEO Aviva Investments Mark Versey
"Our purpose is to be with you today, for a better tomorrow".

Brunel, Chief Responsiblity Investment Officer Faith Ward
"Brunel Pension Partnership Limited (Brunel) aims to deliver stronger investment returns over the long term, protecting our clients' interests through contributing to a more sustainable and resilient financial system, which supports sustainable economic growth and a thriving society".

Fidelity International, Non-executive Director and Senior Adviser Romain Boscher
"Helping people to build better financial futures".

Federated Hermes, CEO Saker Nusseibeh
"We help people retire better".

Financial Conduct Authority, Director of Environmental, Social and Governance Sacha Sadan
"We aim to make financial markets work well so that consumers get a fair deal".

Generation Investment Management, Founding Partner and Senior Partner David Blood
"Our purpose is to drive to a net zero, fair, healthy, safe, prosperous society".

ITV, CEO Dame Carolyn McCall
"Our purpose is to entertain and connect with millions of people globally, reflecting and shaping culture with brilliant content and creativity".

Legal & General, CEO Sir Nigel Wilson
"Our purpose is to improve the lives of our customers, build a better society for the long term and create value for our shareholders. We want to be economically and socially useful".

London Business School, Professor Alex Edmans
"We challenge conventional wisdom, transform careers and empower our people to change the way the world does business".

M&G Investments, CIO Jack Daniels and Head of Catalyst team Mark Seddon
"Our purpose is to help people manage and grow their savings and investments, responsibly".

NatWest, CEO Alison Rose
"To champion potential, helping people, families and businesses to thrive".

Pets at Home, CEO until May 2022, Peter Pritchard
"Our purpose is to help pet owners be really great pet-owners".

Lord Mayor – City of London on sabbatical from Chair of Phoenix, Nicholas Lyons
"Helping people secure a life of possibilities".

Royal Society of Arts, CEO Andy Haldane
"To enrich society through ideas and action. We believe that all human beings have the capacity for creativity that can be mobilised to deliver a better future for all. We call this a 21st century enlightenment".

Severn Trent, CEO Liv Garfield
"To serve our customers and communities. This drives our vision to be the most trusted water company by 2020 and every year thereafter".

St. James Place Wealth Management, CEO Andrew Croft
"We exist to give you the confidence to create the future you want. We do this through face-to-face financial advice, delivered exclusively by qualified, expert advisers who make up our Partnership".

This report is based on interviews conducted between December 2021 and December 2022 together with supporting research, following The Purpose Tapes published in June 2021. They are the most thorough on-the-record assessments of the state of play on purpose and its potential by business and investment leaders ever made in Britain. To help readers, the Report at a Glance briefly sets out the main themes and conclusions. The longer Executive Summary details the main arguments, conclusion and recommendations, while the chapters contain the rich material from the interviewees themselves. We thank all those who gave up their time to be interviewed and hope you find the result interesting and illuminating reading.

The Steering Group TPC

Report at a glance

This report confirms the growing view in business and investment circles that companies with a declared and enacted purpose which inspires value creation for all material stakeholders are more institutionally resilient, cohere better as organisations and are generally better at producing high levels of sustainable value over time. It makes bold recommendations about how the British ecosystem can be reformed better to encourage companies to form and grow around purposeful principles over their life cycle, thus trying to address the significant shortcomings in the way the British ecosystem currently works. If the gaps can be closed and new processes put in place, reshaping British capitalism around purpose is one of the preconditions for greatly improved economic performance.

Unsurprisingly the practice and impact of purpose varies from company to company. Purpose is not an iron law that guarantees success: rather it provides a framework of principles and guide rails for action that leans into long term value creation. Delivering purpose over time is demanding and hard work. It must be embedded in strategy, objectives that flow from strategy, the operating model and in company values.

Yet there is impressive unanimity across a range of business and investment leaders alike that a 'north star' of purpose energises their companies. Britain's four leading insurance companies, for example, accounting for over £2 trillion of assets and all interviewed for this report, expressed belief in purpose not only as animating their day-to-day operations but as informing how they should strategically manage liabilities and assets that are up to 40 years in duration. Thus they are willing to play a part in creating a potential national wealth fund that will support young and growing companies purposefully exploiting new technologies – which they see as offering excellent financial returns and as being the right thing to do. Other companies we interviewed pointed to purpose delivering high levels of employee engagement, customer focus and the capacity to navigate difficult tradeoffs successfully.

However, there is progress to be made. Investors and companies alike have to overcome the reality in practice that meaningful mutual engagement over their purpose is time consuming, expensive and from the company point of view involves too many disparate asset owners and managers. There need to be better reporting templates, better engagement processes, better two way communications and more shareholders assuming an 'anchor' role with a better understanding of how to do purpose and what to watch for when monitoring progress.

The recent rise in interest in purpose has been paralleled by a rise in the interest in investing to achieve Environmental, Social and Governance (ESG) objectives. Although some argue that in the 2020s it is hard to be purposeful without also being committed to environmental sustainability so that purpose and ESG get intermingled, in fact the concepts are analytically distinct. Purpose answers the question of 'why' the company exists. ESG is a dashboard of actions to achieve specific objectives within a business model driven by purpose.

There is some backlash in the US about ESG investing, driven in particular over 2022 because funds underweight in energy companies, as ESG funds tend to be, have underperformed the market in a year of soaring energy prices. There are fears these concerns may detract from British investors' commitment to ESG and by inference purpose. However, all our asset managers and asset owners remained strongly committed to both because they firmly believe that commercial imperatives and delivering better ESG outcomes align. In any case, if this is what the ultimate saver wants, that is their prerogative.

Recommendations include:

- The creation of an up-to £100 billion national wealth fund, one component private sector – provided by Defined Contribution Pension fund allocations largely – and the half other separately funded from the public sector. The twin funds would be managed in parallel with the whole supervised by an independent board. It would be the anchor shareholder in start-ups and scale-ups in the 4th Industrial Revolution technologies, securing their purpose and keeping the businesses domiciled in the UK. Amongst other functions it would be a bridge between private equity and public markets strengthening the complementarities together with other strategic investment opportunities such as green technologies.
- Purpose to be expressed in the regulated utilities by companies incorporating as 'public benefit companies' of whose shares a quarter would be publicly listed to ensure common standards of transparency and accountability.
- Government to initiate regular ecosystem reviews to ensure as far as possible that failure and gaps are closed where necessary by creating investible opportunities for private funds especially ESG funds and public private partnerships for companies. Training and human capital would be a particular focus.
- Shareholders to have a regular 'say-on-purpose', supplanting the say-on-climate, thus promoting engagement on both companies' policy on purpose and its delivery.
- Purpose reporting to be incorporated in companies' strategic reports.
- The more incentives are aligned with purpose the better. The Purposeful Company has recommended replacing LTIPs with long-term, long-held stock and we continue to advocate this development.
- The creation of an annual asset managers and owners summit to develop more common recognition among asset managers and owners that their purpose as investors is to lift the general performance of the companies in which necessarily everyone invests.

These proposals taken together with others we recommend could reshape British capitalism for the better. They are all feasible – some of them simply scaling existing practice – and they would significantly address the recent concerns expressed by the Investor Forum that the focus of company and investor dialogue should return to the creation of long term value. There is growing frustration. Britain has great assets – financial resource and expertise, ideas at the frontier of technology and a track record of starting wonderful companies. Yet it fails to capitalise on them sufficiently. Here is a programme of reform that could trigger genuine and sustained change.

Executive Summary

The precondition for sustainable growth is a critical mass of great companies which will invest, innovate and add value to propel it. Britain has too few. It needs more if it is to escape the current profound economic and social crisis.

The contention of The Purposeful Company since its foundation has been that great companies are founded on a purpose that sets out why the company's business will one way or another make the world better. A company's declaration of purpose answers the question why it exists. It credibly expresses an intrinsic purpose that will deliver societal improvement, moral underpinning to the firm's activities and create long-term value.

Both in The Purpose Tapes published in 2021 and in this report, Advancing Purpose, we present the strongly held view of a cross-section of successful business leaders whose business experience is that deep commitment to a north star of purpose can be a rich source of competitive advantage and employee inspiration. It guides strategy, informs policy, expresses ethical values, offers a compass when difficult decisions and tradeoffs have to be made, stimulates good outcomes which otherwise would not have happened and energises employees and wider stakeholders. Purpose helps bias companies from networks of contracts and transactions to institutions that command loyalty and even enthusiasm.

Purposeful business is also deliberate about making purpose live. What is critical is that purpose informs business strategy and the choices the company makes about how it will create value and how its culture, values and its operating model will align around that purpose This design for purposeful business was laid out clearly in The Purposeful Company's reports in 2016 and 2017 and then codified through the FRC's revision of the Corporate Governance Code in 2018.

However, there is clarity needed about how distinctive company assets can be used to create value for all material stakeholders. Being purposeful is not just a question of 'doing no harm' (although this is important), it is about actively using purpose to 'do good'. It needs to be embedded in the heart of a company's structures and so brought alive. The challenge is thus not only to win more adherents, but to improve the practice of purpose. This should be reflected in how and what companies report. Yet the Financial Reporting Council (FRC) reported in 2020 that only 21% of companies in the 86% of FTSE 350 companies who declare their purpose gave a clear description of why they exist, specified their market segment, set out their unique selling point and how they will thus achieve their purpose.

So although the benefits of purpose are more widely accepted than they were seven years ago when The Purposeful Company was founded, it is still work in progress. It remains a young concept with which both the majority of companies and investors have yet to grow familiar and properly operationalise as reflected in the FRC report. Only a fraction of shareholders are sufficiently long term in their outlook to want to capture the long run improvements in performance that purpose can be expected to drive, so that it takes time for the proposition both to mature and become widely accepted.

Moreover there are criticisms that commitments to environmental, social and governance goals (ESG) which flow from purpose have been abused by some keen to cash in on the boom in ESG investment by 'greenwashing'. There have been police raids of Germany's largest asset manager DWS over potential ESG falsification leading to the resignation of its CEO; in the US there is growing criticism from the political right that ESG is a Trojan horse for the left to achieve aims it cannot achieve through the ballot box, which has created a live American debate about the integrity of ESG – and by inference purpose.

But the backdrop is that over the last five years the fastest growth in funds allocated to British asset managers or held by asset owners are those dedicated to promote ESG; these now constitute as much as a third of the funds under management in the UK. This reflects strongly held and growing views from stakeholders and civil society alike that observing ESG principles not only makes good business sense but it is the right thing to do. Strikingly leaders of Britain's leading four insurance companies interviewed in this report, are all committed to business purpose and ESG which they believe, given their 30 and 40 year time horizons, is a business and social imperative. None signalled any retreat from this conviction. They are purposeful companies compelled to have a long-term view of what that means.

Given the salience of climate and demographic change on attitudes and behaviour interacting with the new transparency about corporate actions enabled by social media, new sources of data and technology, the pressures are not going to lessen. A response is not just about protecting one's business model: it is to protect one's reputation.

This matters for purpose. **For if purpose addresses the question of why a firm exists and its distinctive role in the world, ESG is an important means for purpose to be expressed in strategies and actions.** ESG should be regarded as a dashboard of initiatives and practices that a purposeful company will want to pursue, many of which will flow from its purpose but are not its purpose per se. Although not the same, in practice for example the pressure to act sustainably is becoming seen as integral to purpose.

Thus the more market pressure forces institutional shareholders to reflect ESG priorities in their investment policies, the more the case for purpose is advanced. If the reporting framework is underdeveloped, so threatening to weaken ESG conceptually, there has been a conscious, international drive to remedy matters. There are moves within the Integrated Reporting Framework to inject common standards for sustainability accounting developed by the Sustainability Accounting Standards Board – with work in parallel launched by the EU. The Financial Conduct Authority has initiated a consultation on a better labelling system for ESG categories. As one influential report puts it, there is now no turning back.

If British capitalism is to get the reset it urgently needs, then further entrenching the case for purpose and the best delivery of ESG are necessary if insufficient preconditions. The asset managers and owners we interviewed all believe that the desire to invest on ESG principles will if anything intensify and they understood that results best flow from companies committed to purpose.

In this respect the growing commitment to ESG is a gateway even for those investors only semi-convinced in the purpose case to take it more fully on board.

Equally business understands and shares these beliefs even while it wants shareholders to take as much if not more notice of the case for purpose. This report presents a wealth of detailed interviews with business and investment leaders, along with buttressing research, which examines the actors' reflections on how they could better get on to the same page and make common cause. It concludes by offering a range of potential ecosystem reforms and initiatives that could help achieve that end. In particular the creation of a national wealth fund would offer the supply of capital crucial for many of these aspirations to become reality – and build linkages between the private and public markets that are so vital. Of course these proposals would need to be nested in other reforms – on training, infrastructure, Research and Development (R&D) – but part of the story of driving towards a wealthier, sustainable and growing economy is a step change in the numbers of great purpose-driven businesses. This report is a contribution to that cause.

Companies *and purpose*

For a company to commit to being purposeful is a profound statement of intent. It requires a leadership team who is bought in to the proposition, a real connectivity made between purpose and strategy, engagement with stakeholders to ensure comprehensive buy in and in particular a critical mass of shareholders who are supportive. All this presumes a wider ecosystem that smiles on the entire exercise. As the FRC report cited earlier highlighted, even if progress has been made Britain has some way to go.

The first step is to acknowledge that the benefits of purpose unfold over time. Therefore companies who want to start on this journey commit to a continual and ongoing demonstration of how purpose is creating value by anchoring their reports and disclosure of information around demonstrations of its successful use. The better they can articulate and communicate the benefits, the more they can create a shareholder register of whom a critical mass will align with their purpose and strategy. One of the best demonstrations is to report how successful coherent long-term plans have been developed by the linking of purpose to strategic goals: everything then adds up – from the creation of long-term value through to the assessment of material risks and even the identification of relevant metrics with which to track progress.

But as matters stand, as the FRC comments, **the majority of purpose statements are too vague and aspirational, lacking substance and useful mechanisms for accountability. They certainly do not provide useful forward looking material information that bears on future trading prospects – in particular how potential environmental, social and governance developments may impinge on the business model, and thus on the ongoing capacity to deliver purpose.**

However a growing number of investors want companies to offer guidance on this range of issues. Some investors want to go further, looking for guidance on how companies believe currently non-financial, non-material trends and developments will, in their view, become material in the future and consequently impact on purpose.

The CEOs we interviewed all expressed a desire to disclose material information of this kind – so better rolling the pitch – along with publishing long-term strategic plans that flowed from their purpose and had a track record of so doing comparatively successfully within the regulatory constraints.

There are well-known problems about disclosing commercially sensitive information that topples shareholders into becoming unwanted insiders, unable to act on the information because it would represent insider trading. But business leaders agreed that could be overcome by an intense commitment to communication and expressing material risks in terms of ranges and probabilities. The greater problem is that apart from committed long term shareholders, few other shareholders seemed to be sufficiently interested in questioning companies about purpose – even though a growing number interrogate companies over ESG. One of the avenues to get wider buy in was to enlist the Chief Financial Officer and team, both to increase the weight of executive opinion supporting purpose, but also better boosting the credibility of reporting the benefits that flow from it.

The speed of ESG's rise has taken the rating and appraisal system off guard. **The methodologies and criteria behind ESG labelling, measurement, ranking and delivery across a range of very different companies was widely felt to be insufficiently robust.** All this is reflected in the wide divergence between Individual credit rating agencies' assessments of a company's ESG performance.

Given this near 'wild west' it thus falls to companies who are committed to delivering environmental, social and governance goals to make ESG intrinsic to their strategy and to do so rigorously and credibly in their own terms. They may not even use the ESG label for their internal deliberations, but they ensure that what they do and how they report it makes absolutely clear their well-designed commitments and their progress in meeting them. Indeed, in so doing they help construct a competitive landscape in which ESG is central, mainstreaming it as nothing less than sustainable mainstream business. It is not woke any more than purpose.

There was agreement that the delivery of purpose is a whole enterprise affair, requiring the engagement of all stakeholders beyond shareholders to include employees and customers. It is employees who know most about the inner workings of any business and its markets, and whose energies need to be most enlisted to drive the firm forward. Here the UK ecosystem and culture cannot yet be counted as leaning into this agenda. So although the Corporate Governance Code offers a number of ways formally to engage, enlist, consult and inform employees about decisions, companies in the main are reluctant to create formal mechanisms for significant and deep employee engagement.

However, purpose-driven companies are experimenting with consultative panels and other means such as companywide profit sharing schemes which reinforce the principle of sharing rewards for sharing a purpose. But the wider evidence is disappointing. Workplace task discretion, one proxy for managerial trust in workforces, is if anything in decline.

Equally for all the references to the importance of customers, in general British efforts to engage with them formally and systematically to incorporate their feedback in the way the company does business are underdeveloped. Purposeful companies of necessity tend to make greater efforts monitoring customer reactions and matching employee engagement scores with customer satisfaction.

However, the development, for example, of Consumer Challenge Groups (CCGs) created by some utilities to give consumers a more active voice is still in its infancy. Where used by utilities they have helped shape companies' customer engagement programmes and helped ensure consumers' views are reflected in their business plans. A number of utility companies now define themselves as companies engaged in promoting public benefit sensitive to wider stakeholder concerns – public benefit companies. However this is not widespread.

Purposeful companies are still pioneers within a wider ecosystem that while not openly hostile to purpose, and its sponsorship by stakeholder capitalism, is not especially welcoming either. The mainstreaming of purpose requires this calculus to be changed.

Asset Managers *and purpose*

A major practical obstacle to achieving purpose in Britain is the intense and near unique fragmentation of British shareholding structures which make it harder to get sustained buy in for strategies with long-term payoffs. Whereas companies based in other countries one way or another can look to support from a critical mass of a few independent blockholders or anchor shareholders in one guise or another for the delivery of purpose-led strategies, that is not the case in Britain. In many respects the debates about investor engagement and stewardship are in truth debates about how to offer similar support but in a world of investor fragmentation.

Asset managers (and asset owners) recognise that reproducing blockholder effects can be beneficial to the performance of the companies in which they invest – but they compete for mandates, are prohibited from acting collectively by anti-collusion regulation, and in general do not want to become insiders by being given market sensitive information in a context they cannot act. There are also a lot of them: one company we interviewed reported over 250 institutional investors with disparate expectations and as a result strategy was about achieving the mean rather than the best. For companies and investors alike, there are gains to be had by investors at the very least co-ordinating their approach if barred from acting collectively.

We identified varying strategies to achieve a simulacrum of blockholder effects. One is to predeclare openly and publicly to the entire market your attitudes and expectations, with some publishing them in expectation documents such as the Norwegian Sovereign Wealth Fund's document or reports setting out their investment principles like the Generation Investment Management's publicly stated strategy and societal objectives. Thus other investors – and companies – know the likely stance on any issue, and how the asset manager will react without having to make contact which could be interpreted as collusion. There is some academic evidence that companies do respond to the intentions conveyed in such documents, especially the greater the shareholding.

Others look to invest to bulk up the stake held by the founder or the founding family, especially in those cases where the founder's purpose is well established. Others again are prepared to work with independent third parties such as the Investor Forum, or with a commercial third party like Robeco, to try to achieve critical mass by open co-ordination. Some academic evidence supports that co-ordination is best achieved by using independent third parties.

However the difficulty in all these cases is that support is implicit because it cannot be either openly expressed or guaranteed over time. The disadvantage of co-ordination via a third party is that it only emerges in a particular flashpoint or crisis. No strategy reproduces the full blockholder effect.

Inevitably supportive initiatives need to be supplemented by consistent engagement with companies – at the very least regular meetings with the leadership team. Such conversations, some believe, need to be extended to as large a group as possible of stakeholders to get as comprehensive a picture of all the nuances of a particular business model as possible. However, it is obvious this is a time consuming and expensive exercise, as our interviewees confirmed – although each was committed to engagement. The asset managers who can bear the cost either choose to focus on a limited portfolio of say no more than 50 companies or they have sufficient scale to afford a comprehensive engagement effort.

Although a priori there would seem little point in index or tracker funds, who constitute up to a fifth of all funds under management, to undertake engagement because they cannot have above or below weights in shares in the index, in practice larger tracker funds do invest in engagement. It is because they cannot send signals by buying or selling that engagement is the only way to make their views felt. However, the consensus is that while index funds do some monitoring, it is less than the active funds they are replacing.

This seems to be the rule: for many asset managers serious engagement is too expensive, as the academic literature confirms. Nor is there any systematic way for savers or asset owners to monitor and evaluate the success of engagement strategies. Concern was expressed that some engagements are made more visible and public than is necessary with perhaps an eye more for public reputation than value creation: the best engagement, as a number of interviewees signalled, is private so allowing companies to respond and change course without loss of face.

Our interviewees agreed that while they strongly stood by the values of sustainability, ethics, social responsibility and good governance that ESG aimed to promote, and believed the pressures would grow, the debates about the usefulness of the acronym threatened to get in the way of delivery. In this sense ESG is so integral to successful long-term investment that every investment should be made consistent with best ESG practice. It was fundamental to guarding against material business risk in future.

Divestment from problem companies was generally regarded as the wrong approach, a weapon of last resort to be used sparingly: it just passed the problem on to someone else probably less minded to solve the ESG dilemma in the company in question. Co-investment was regarded as far as possible as the best approach to allow companies to transition to better business models, with divestment a last resort.

However a few investors are now tending to harden up their position, sharing in collective letters warning companies that if there is no sign of change within a given period – say three years – they will divest.

Just as companies, given the lack of a common framework in which to locate, rank and evaluate ESG measures, so investors have had to take matters into their own hands, creating their own narrative and reports – using their own framework and research alongside the credit rating agencies' assessments. A growing number have become signatories to the United Nations Principles for Responsible Investment (PRI) that commits them to incorporate ESG factors into their investment decisions.

More widely there are other initiatives: some data providers are leveraging artificial intelligence continually to update the weights they apply to individual components when calculating overall ESG ratings. The Holy Grail is to create common accounting statements that transparently capture external impacts that can drive investor and managerial decision making, for example the aim of the Integrated Reporting Framework. In Britain the FCA is developing improved and clear ESG labelling with international applicability.

All our asset managers were clear that purpose was the higher order dynamic from which ESG flows: ESG is seen as a dashboard cum checklist of things needed to be worked through to achieve dimensions of purpose. The important news is that investors, companies and regulators know they have to develop practical answers and are doing so.

Asset Owners *and purpose*

Asset owners are in pole position to drive forward purpose: whether they manage their assets directly themselves or contract out all or part to professional investment management companies, they speak for the owners directly. How they set out their investment priorities in their mandates radiates around the capital markets. The FCA pointed to the Net Zero Asset Owners Alliance as an example of the positive impact asset owners are increasingly having when co-ordinating their approach.

Asset owners increasingly publicly state their investment policies. One example is the Brunel Pension Fund Partnership, a group of jointly managed local authority pensions which in their Responsible Investment Policy Statement set out seven priorities that their savers expect and target Brunel, as custodian of their savings, to meet: they are climate change, advancing UK-wide policy initiatives such as the corporate governance and stewardship codes, diversity and inclusion, human capital, cost and tax transparency, cyber-security and supply chain management. Asset owners tend to be universal owners in the sense of having assets in most firms and investment classes: they look to improve general performance through high levels of engagement, recognising there may be short-term costs for sustainable long-term performance.

As a result there is some evidence of tension between asset owners and asset managers over how engagement is undertaken, with voting a particular flashpoint. There is an increasing number of asset owners wishing to be involved more closely in voting decisions, retaining voting rights (pass-through voting) or delegating voting only within clear and transparent guide rails. They are reluctant to see voting rights on issues that are important to them delegated to proxy agencies.

Unsurprisingly most asset managers see voting as an integral part of the engagement process and are reluctant to give up the right; pass-through voting suggests lack of trust or poor communications between asset owner and asset manager. However as the debate in the US over shareholder enfranchisement develops, and arguments for more shareholder democracy (for example the notion of a 'say on purpose') potentially gain more traction, it is likely that asset owners will take greater interest in how their votes are cast.

Increasingly, asset owners are investing directly in private (private equity, early stage companies, infrastructure, social housing) rather than publicly listed assets where they see both commercial advantages and the ability to insist their investment principles are being followed. To the extent they are persuaded that purpose-driven businesses are value generating, they are a potentially important catalyst in raising the salience and deployment of purpose in business – mirroring the interest shown by the great insurance companies. They want bespoke answers to their questions and concerns. From the investee companies' point of view, while they welcome the growing interest by asset owners in purpose, answering varying asset owners' (and asset managers') questions is time consuming and increasingly onerous. There is a need to find better ways of making these exchanges time efficient.

This interest is reflected in a growing trend to invest for social impact, including directly in private equity, as a means not only to boost financial returns but also to ensure that asset owners' preferences for purpose and ESG are properly met. Investment in private equity makes particular good sense where there is close alignment between management teams and owners so ensuring purpose is pursued; the relationship can work well as reported in the companion TPC paper Private Equity and Purpose. As part of this picture Legal & General is part asset manager, part asset owner who invests directly in start-ups and supports them scaling with considerable success, both in terms of shareholder/policyholder returns and in terms of meeting its purpose.

In a recent letter to the Financial Times, asset owners representing £675 billion of assets set out their support for purposeful companies clearly explaining their purpose, pursuing appropriate ESG objectives, engaging with all their stakeholders and warning shareholders of material risks to their business:

> *"These are the building blocks of stakeholder capitalism. It is not woke. Rather, it is a powerful form of capitalism that unleashes mutually beneficial relationships to create long-term value. Our interest as asset owners must focus on what is financially material. We also recognise that what is financially material will change over time and companies are right to guard against that, clearly alerting us to what they are doing to secure corporate performance over the long term. It is this dialogue that enables us as asset owners to share the same approach as the businesses in which we invest".*

The open question is how best this can be further advanced. Indeed, an immediate resolution is an imperative. Raising business investment will have a crucial role to play in solving Britain's economic challenges. The asset owner and asset manager community needs quickly to align around a vision of their own purpose – which must surely address the issues raised in this report.

Conclusion

The interest in and commitment to purpose, growing over the last seven or eight years, is gaining ground. For example, Britain's four largest insurance companies, all interviewed in this report, are now committed to promoting purpose, both within their enterprise and as importantly through their impact on the wider ecosystem in the long term. This is an imperative: each faces having to develop long-term assets to match their long-term liabilities, which necessarily need to promote future growth, societal wellbeing and environmental sustainability which their retirees can enjoy in 30 or 40 years' time. For companies with over £2 trillion of assets under management this is an important recognition with profound implications.

The value of purpose was shared by all the asset managers and owners we interviewed. Equally publicly quoted companies (some interviewed in this report) report that pursuing purpose helps to promote stakeholder buy in to their mission, sharpens what is distinctive in their business model and helps navigate the inevitable tradeoffs and challenges in business decision making more successfully. Pursuing purpose is not the guarantor of building and sustaining value generation over time, but it is an important precondition. If the UK were to possess a larger critical mass of purpose-driven companies, our proposition is that it would lift levels of investment, innovation and growth.

Throughout this report there has been discussion and references to ESG which although associated with purpose is analytically distinct. Purpose addresses the 'why' of a company, while the focus of ESG is on policies which although they may help that 'why' to be implemented through promoting ESG objectives, are not the same. It is the goods and services that a company creates through its purpose that generate long term value. ESG provides guide rails in which value creation takes place but does not answer the question: why? However, as a number of interviewees acknowledged, as sustainability rises in salience a growing number of companies write in a sustainable dimension to their purpose.

ESG is suffering criticism conceptually, politically and practically especially in the US. Critics allege the pursuit of ESG obstructs value generation. Defenders insist the opposite, as do the interviewees in this report, who also argue that if asset owners and the providers of savings want strong ESG policies to be in place in the companies in which they invest, that is their prerogative. Our interviewees believed strongly that sustainability makes business sense. As matters stand the flow of funds towards ESG investment is showing every sign of increasing – with moves afoot domestically and internationally to draw the sting from current criticisms. Both purpose and ESG in their different guises are here to stay.

This is important, if as we argue, they are important preconditions on which to build a generation of great companies that Britain now needs so much. This was stressed by a number of our interviewees.

One concept that would address many of the issues raised in this report – the need for more long-term anchor shareholders committed to purpose over firms' life cycles with the resource to engage with their investments – would be the creation of a national wealth fund supported by long term pensions' assets. The seven countries with the biggest pension fund pots invest on average 19 per cent of their assets in illiquid infrastructure, private equity and certain kinds of real estate. Britain invests only 7 per cent. In the opinion of Nicholas Lyons, Lord Mayor of the City of London on sabbatical from chair of Phoenix Group, if the four major insurance companies contributing to this report were to give a lead, less than 5 per cent of the £500 billion of Defined Contribution workplace pensions (expected to grow to over £1 trillion by 2031) plus a proportion of SIPP assets of nearly £800 billion could be allocated as a cornerstone for a newly established private national wealth fund and still not reach the international average.(Defined Benefit Schemes could play their part by increasing their corporate bond exposure, an asset class to which they are more suited). This private sector wealth fund should then be matched by government to create eventually a £100 billion fund or more that would invest in early stage companies (and others) embodying Fourth Industrial Revolution technologies, green technologies and purposeful enterprise and continue to support them as they grow, so helping to create a critical mass of fast growing, British based companies. Taxpayer and pension fund monies would be kept separate although managed by the same independent board. As long as the illiquidity and fee implications can be solved, the concept would work well and in the process better bridge the world of private equity and the public markets. Early stage companies of the type backed by private equity would lean into purpose from the outset, and a holistic view could be taken as they transition to the public markets – but biased towards remaining domiciled in the UK.

There is also a case for foregrounding purpose more in law, moving from the soft law of regulatory codes and guidelines to statutory law, thereby clarifying that directors' fiduciary duties include the delivery of corporate purpose. Supporting this there is a strong case to develop a regular 'say-on-purpose' through which shareholders could register their approval of both the policy toward purpose and its implementation – thus generally raising the salience of purpose-driven business strategies. It would supplant the say on climate, particularly as more and more companies include an environmental sustainability commitment to their purpose. One additional practical development that could strengthen the practice of purpose is the encouragement of regulated utilities to incorporate as public benefit companies, potentially as a condition of being given a licence to operate. They would be consecrated to delivering their goods and services so crucial to life as efficiently, reliably, cheaply and sustainably as a social purpose, from which long run profitability would derive. At least a quarter of all public benefit company shares should be listed on public markets to ensure common standards of accountability and transparency.

ESG must not over prioritise a commitment to the 'E' of environmental sustainability, and not downgrde the 'S' – notably the education and training ecosystem. The UK should engage in regular assessments of the human capital ecosystem, and where possible create a public private partnership with the development of investible propositions that allow better transitioning to a Fourth Industrial Revolution industrial base offering opportunity and skills across the age range of the workforce.

Over the report we have suggested a number of improvements to reporting, in particular building the purpose report into the strategic report, so showing how the pursuit of purpose creates long-term value. This would help better frame the identification and reporting of future developments that may materially impinge on the company's business model. Board accountability for these developments should be as explicit as it is for current reporting of the firm's financial viability. We welcome the efforts to improve ESG reporting around internationally agreed standards; however if these are to be applied beyond the investment community and adopted by the broader business world, the FRC – or its successor ARGA – should take the lead in international standard development. We support the establishment of sustainability committees to drive both the ESG and purpose agendas, and stand by our long-standing commitment to replace LTIPs with long-term, long-held stock better to align incentives with long-term sustainable value creation. And lastly we urge the creation of an annual asset managers and owners summit to develop more common recognition among asset managers and owners that their purpose as investors is to lift the general performance of the companies in which necessarily everyone invests.

These proposals taken together would reshape British capitalism significantly for the better. They are all feasible, some of them simply scaling existing practice. Moreover they would significantly address the recent concerns raised by the Investor Forum that the dialogue between companies and investors should return to focusing on long-term value generation.

There is growing frustration. Britain has great assets – a considerable pool of financial resource and expertise, abundant ideas at the frontier of technology and a track record of starting wonderful companies. Yet it fails to capitalise on them sufficiently. Here is a programme of reform that could trigger genuine and sustainable change.

Summary of *recommendations*

Ecosystem Reform

- Britain's top insurers to be encouraged in their aim of launching **a £50 billion private sector national wealth fund** (with protections to ensure its independence from any potential politicisation of decisions) to act as an anchor shareholder in British companies, in particular high tech start-ups and scale-ups. Regulatory and fee issues to be addressed. This should be matched by an **up to £50 billion public sector wealth fund** whose assets are managed in parallel by an independent management board.
- **Regulated utility companies to incorporate as public benefit companies** to deliver a social purpose as the condition of their licence. The aim would be to create an asset class of public benefit companies of whose shares a quarter would be publicly listed to ensure a level playing field of accountability and transparency.
- Company law to be reformed to offer clarity that **delivering purpose constitutes a proper fiduciary duty**, along with templates for a variety of corporate forms embodying purpose.
- Government to institute **regular assessments of ecosystem strategic weaknesses in the UK** – building on the '6 capitals' framework in the 2021 Levelling Up White Paper. This would include an assessment of strategic labour availability and skills deficits, and identify investible propositions and potential public private partnerships which companies and investors alike can take up in their ESG strategies.
- Accelerate the merger and creation of **partnerships between the multiplicity of public sector pension funds** to achieve more scale.

Strengthened Governance

- The impending 2023 update of the Corporate Governance Code to require **Purpose Reporting to be covered in the Strategic Report**, linked with ESG initiatives and audited. Companies should demonstrate in their reports that pursuing their purpose leads to improvements in long term value generation – the template in this report's Appendix is one potential framework.
- Encouragement of the initiatives underway by the FRC on updating the **Corporate Governance Code to be more explicit about ESG Reporting** building on the definitional work underway by the FCA.
- The FRC (and thus its successor ARGA) to be appointed by the Government to oversee the development of **UK input into the development of International ESG standards**.
- The revised Corporate Governance Code should set out expectations of best practice in employee engagement, including but not mandating the **establishment of profit-sharing and ESOP schemes** – and also for consumer engagement via Consumer Challenge Groups (or similar).
- A **Say on Purpose to be developed to supersede the Say on Climate**. This may take some years to become an embedded and widely accepted practice, but it is a potentially important route to raising the salience of purpose and promoting a proper dialogue between companies and investors over the costs, benefits and tradeoffs of pursuing it. Even opening a dialogue over its potential introduction would signal its importance.
- This would be reinforced by **greater use of pass-through voting**, where appropriate also demonstrating to regulators that purpose and ESG strategies reflect asset owner preferences.

Board Accountability

- **Board accountability for Purpose Reporting** to be as explicit as it is for the reporting of firms' viability.
- The revised Corporate Governance Code to call for the **establishment of sustainability committees**.
- The more incentives are aligned with purpose the better. The Purposeful Company has recommended replacing **LTIPs with long-term, long-held stock** and we continue to advocate this development.

Transparency on Asset Manager Stewardship and Asset Manager Mandates

- Asset Owners to establish an **'Asset Owners Purpose Alliance'**, part of whose role would be to make investing in purpose-led companies a priority in asset manager mandates and to set guidelines about how asset manager engagement over purpose should be organised.
- Companies to create **'Glassdoor' style reporting on the quality of stewardship** experienced and how well asset managers deliver on their purpose statement.
- **Third Party leadership and intervention to co-ordinate asset management engagement** is of proven importance. Consideration should be given to deepening and scaling the Investor Forum's role.
- The **creation of an Annual Asset Managers and Owners Summit** to develop more common recognition among asset managers and owners that their purpose as investors is to lift the general performance of the companies in which necessarily everyone invests.

To see the full Advancing Purpose report:
www.thepurposefulcompany.org/reports

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