Advancing Purpose

How purposeful companies and investors can make better common cause

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.

Contact thepurposefulcompany.org

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”.

Report Structure

The Interviewees 3

Report at a Glance 6

Executive Summary 8

Introduction 20

Chapter One: Companies and Purpose 26

Chapter Two: Asset Managers and Purpose 50

Chapter Three: Asset Owners and Purpose 65

Conclusion 72

Recommendations 84

Appendix 86

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 the aim of establishing a £50 billion private sector national wealth fund (with protections to ensure its independence from the politicisation of decisions) to act as an anchor shareholder in British companies over their life cycle, in particular high-tech start-ups and scale ups. Regulatory and fee issues to be addressed. This together with other strategic investment opportunities such as green technologies should be matched by an up to £50 billion public sector wealth fund whose assets are managed in parallel by the same 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 common standards of accountability and transparency.
- Company law to be reformed to offer clarity that delivering purpose constitutes a proper fiduciary duty, along with offering 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 public private partnerships which companies and investors alike can support 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 the 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 under way 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 require companies to set out expectations of best practice in employee engagement, including but not mandating for example the establishment of profitsharing 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, 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 firm viability reporting.
- 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.

Introduction

The urgent need to boost Britain's disappointing economic growth record since the financial crisis of 2008/9, falling further since Brexit in 2016, is now common ground across politics, finance, business and economic commentary. On top, growth must be environmentally sustainable given the urgency of meeting targets for net zero by 2050. The open and controversial question is how this can be done. After all it is not as though this problem is new.

However what is curiously neglected in the debate is how appropriately our major companies are owned, governed and managed so they play as vigorous a part as possible in raising growth – and doing so sustainably. Bluntly, without a critical mass of such great companies, hopes for a higher, sustainable growth rate are likely to be disappointed.

This lacuna is especially curious at a time when there is a growing view in civil society that companies should be better citizens and that their profits would best result from serving a wider social purpose. Over the last five years the number of publicly quoted companies who have responded to this twin challenge by offering statements of their purpose that they claim to live – going well beyond former commitments to corporate social responsibility – has steadily grown. They argue, witness the cluster of comments below from business and investment leaders, that living your purpose is intrinsic to a strong growing business. Business purpose is a statement of what the company is fundamentally about for the long term, a north star that explains how it will in some way improve the world, from which strategy, values, reputation, growth and profits will derive. This can be seen from their operational behaviour and multi-stakeholder engagement. In her interview for this report **Carolyn McCall, chief executive of ITV,** strongly sets out the case for purpose as a business driver.

> *"I completely believe 100 per cent that having a North Star of purpose is really enabling, helpful and creates value. Always have done. So, our purpose as a public service broadcaster is to connect and entertain and inform. But it's more than that. Yes, it's about connecting millions of people, doing, and using things for good. It's also to reflect and shape society in our shows. Everyone understands that our purpose is about more than just TV. And that drives our strategy, our values and our profitability".*

Liv Garfield, CEO of Severn Trent, describes it in these terms:

> *"Purpose is a commitment for the longer term. Once you have purpose embedded in your strategy, in your organisation, once the whole organisation feels the purpose of the company and it's in the DNA, then I'm sure it drives growth, performance and value".*

Romain Boscher is a long-standing senior executive at Fidelity International, now joining its board as a non-executive director and senior adviser, which as an asset manager manages close to £1 trillion. He strongly supports McCall's and Garfield's position.

> *"Purpose for me is a key pillar for any company strategy. If you don't have a purpose, then the danger is defining a strategy but then not being able to*

execute it. The purpose is the glue between your plan and what you are implementing in real life. Purpose is value creating, that's for sure. We are convinced of that".

David Blood, founding partner and senior partner of Generation Investment Management, frames his purpose in these terms:

"Our purpose is to drive to a net zero, fair, healthy, safe, prosperous society. And that's how we deploy capital, that's why we come to work, and we think that ultimately sustainable capitalism will result in a more robust economy and society for all".

All those we interviewed shared these views, believing that the companies they led or invested in performed more strongly because they were purpose-driven. **Sir Nigel Wilson, CEO of Legal & General**, sets out the rationale and its results:

"We want to be economically and socially useful as part of our north star of purpose. We're very privileged we can take a ten, twenty, thirty, forty-year view of our business performance. We live in a world awash with ten, twenty, thirty, forty-year liabilities – pension, climate, insurance liabilities – and we think it's our job with our long-term liabilities to create the long-term assets that match those liabilities – and in the process make the world better. The size and character of our balance sheet gives us a huge amount of freedom to think outside the box about how we can solve economic and social problems with great solutions. As a purpose-led organisation that is our deep purpose.

And it works. There's a lot of evidence we can marshal that we're making real transformation to places round the country – which our customers like. And we are the outstanding performer, in terms of financial returns, in our sector by quite a long way. We've taken the share price from twenty pence to over two pounds and continue to pay excellent dividends all the way through. So, on top our shareholders are very happy with the purpose and the strategy that flows from it".

More prosaically **Peter Pritchard, CEO of Pets at Home (until May 2022)**, identified a one word change to the way the company defined its purpose (and therefore strategy) as being fundamental to strengthening the business

"Our purpose is to help pet owners be really great pet-owners, because I've never yet met a customer who really likes going to the vet or to pet shops. That's what they have to do. The thing that they absolutely love is their pets and therefore we have a role to play. Five or six years ago we made ourselves even more purposeful by changing a word in our strategy. Our ambition had always been to be the best pet shop

in the world, and we changed that to say our ambition was to be the best pet care business in the world. And that simple word change was fundamental. Pet owners are caring for an animal that actually doesn't have a voice; the people who give us their money never ever consume our product. Therefore aligning ourselves to what they're trying to achieve is the starting point of purpose. It is fundamental to running a strong business, you can really share value creation".

Given these convictions and evidence that the pursuit of purpose is value creating, wider takeup and interest might have been expected. However, many in the business community, and even more in the investment community, keep their distance, paying lip service at best. As we write in Chapter 1 there are wide differences in the quality of purpose reporting within the terms of the Corporate Governance Code and how purpose has been implemented: moreover the CEOs we interviewed comment that typically only a minority of mainly longer term shareholders express interest in their purpose. The potential benefits that flow from a more full-hearted embrace of purpose as a fundamental business driver are not being captured as much as they might.

Moreover as the backlash against Environmental, Social and Governance (ESG) principles grows, the case for purpose has been caught up in the eddies. Purpose-led businesses themselves have even been accused of succumbing to woke fashionability, taking their eye off the ball of the necessary focus on shareholder value – notwithstanding their insistence that purpose promotes shareholder value in the long term. Part of the aim of this report is to try to put the case for purpose on a more solid foundation and show how this can be done practically, in particular to explore how both investors and companies can find a common language in which they talk past each other less and make common cause more. The future of purpose is at an important juncture.

However independently from purpose, few companies are able to step aside from the growing pressure to commit to achieve ESG goals – notwithstanding the current controversies. They need to demonstrate that they understand shareholder and stakeholder pressure for change – and are prepared to react with genuine intent. Indeed there is real risk to business models from neglect of ESG issues – for example the US Federal Reserve, along with other central banks, requires banks to undertake stress tests to assess how they might be impacted by climate risk. In this general atmosphere every company needs to be mindful of the dangers of ignoring climate risk, being exploitative or discriminatory – or being perceived to ignore these issues – and on the plus side, the rewards of being seen as a great company with all that flows from it. There need to be commitments on climate change, biodiversity, waste, inclusive work practices, diversity, behaving properly with their supply chain and best practice on a wide range of metrics – and for those commitments to be lived and communicated to employees, customers, stakeholders and indeed shareholders. The explosion of investment funds earmarked to invest in companies on ESG criteria reflects the increasing preoccupation with these concerns by individual savers. ESG now represents a third of all funds under management in the UK. **James Croft CEO of St. James Place Wealth Management** identifies the change:

"Clients are most definitely changing from what they were thirty years ago to today – and quicker than I expected. Take the climate debate. Children are

influencing their parents – and we're really seeing that today over climate. Parents – the average age of our clients is between the mid forties and early fifties – have to reply to their teenage children's questions that they are investing with their future in mind".

His comments were echoed by all the investment managers and asset owners we spoke to. However, there are problematic difficulties. Since work on this report began in December 2021, there have been growing criticisms of ESG. Investigations into DWS, the largest ESG investor in Germany, and Goldman Sachs's ESG funds under management by German and American regulators respectively over allegations of greenwashing, have highlighted how easy it is to use the label of ESG, with at the very least lack of common definitions and criteria, to invest potentially under false pretences. The removal of Tesla from S&P's ESG 500 index captured for many the inconsistencies and confusions over ESG categorisation and rankings. There is a much criticised lack of common definitions and labelling, and too little independent third party scrutiny. This has been further exacerbated by the fallout from the Ukraine war forcing a reappraisal of the social value of investment in defence and fossil fuel companies, and what constitutes sovereign risk: the West needs these companies. While the US is self-sufficient in energy so that concerns about energy use can be downplayed as part of the critique of ESG, the concern in Europe is to wean itself from energy dependence on Russia and the Middle East. This contributes to making ESG concerns in Europe much more business relevant, and less vulnerable to the charge it is woke.

However in the US the arguments are if anything intensifying. Republican state attorneys have written to BlackRock stating that the prime obligation of managers of their funds is fiduciary rather than pursuing ESG objectives, and four Republican led US states have withdrawn $1billion from its management. In the UK the recent early retirement of Alan Jope, CEO of Unilever, follows criticism that Unilever has lost business and shareholder focus in its pursuit of purpose. There are even calls for the acronym ESG to be discarded altogether.

These disputes over ESG are muddying the case for business purpose, which had been advancing steadily for some years. Both are being challenged – although the disposition of asset owners and ultimate beneficiaries to move in this direction has little changed. This report has become more urgent. **Andy Haldane, former chief economist of the Bank of England, now chief executive of the Royal Society of Arts**, sets out the challenges facing the country – and believes purpose-driven business is a critical part of the response:

"Whether you are public sector, private sector or civil society sector we collectively confront enormous societal challenges. Firstly, there are a set of narrowly defined but important economic challenges which have shown up in our inability to grow sustainably at reasonable rates. We do not sufficiently nurture what's sometimes called human capital – the skills and experience of our workforce – and physical capital, the machines and buildings that enable our workforce to be productive.

That's nested within a broader societal challenge – the diminution of trust, of relationships, of the bonds that bind us together as a society with negative repercussions for another capital – social capital. And the economy and society are themselves nested in a broader set of environmental systems where we have seen a continuous denuding of natural capital.

And it's clear that if we are seeking not just to sustain but to replenish these crucial capitals – human, physical, social, natural – there will need to be a collective endeavour that brings together the efforts of government, civil society and private companies. On the last of those, we need to look to purposeful companies – and the pursuit of ESG in them – to rise to the challenge of this cross-generational regeneration task. The challenges are much greater than at any time in the last two hundred years".

David Blood frames the challenge in these terms:

"We absolutely believe that purposeful businesses are critical, but they can't do it themselves. We also need public policy. But – and this is critical – we do not accept the premise that until there's proper policy and frameworks, we can't act. We believe that business can and should act, starting the journey towards the solutions that we need. We know that you can't do it without policy, without civil society or philanthropy for that matter. But that does not absolve business from evolving towards sustainable purpose – and now".

Professor Alex Edmans, author of Grow the Pie, non-executive director of the Investor Forum and member of The Purposeful Company Steering Group, argues that the precondition for growth is great companies driven by purpose:

"As a society, we should promote great companies that create value for both shareholders and stakeholders. Now greatness does involve treating your workers well, and greatness does involve reducing your water usage. But greatness also involves excellence, it involves great leadership, it involves great strategic decisions. None of these fall within the ESG bucket but they're important all the same. We want great companies, not just companies that are great at ESG. And we will get there with companies that are driven by purpose and investors who believe in this purpose and are willing to hold them to account for making it real".

There needs to be an across-the-board step change in presenting the purpose case in order to rise to the moment. It is a major opportunity now to legitimise capitalism and drive it forward across the gamut of stakeholders to meet what Andy Haldane calls "this generational regeneration task". Purpose properly pursued is a key plank underpinning long-term performance, in addition helping to navigate

inevitable tradeoffs and reflect the evolving preferences of employees, customers and investors – but above all to 'sustain and replenish' human, physical, social and natural capital. Interviews with leading CEOs of FTSE companies – ITV, Severn Trent, NatWest, Legal & General, Pets at Home and St. James Place Wealth Management – and senior leaders of leading investment management companies and asset owners – Aviva Investments, Brunel Pension Partnerships, Federated Hermes, Fidelity International, Generation Investment Management and M&G Investments all reaffirm this understanding of the importance of purpose, and their commitment to its implementation. Implementing intrinsic purpose and illuminating issues by open assessment of their potential materiality to investors is vital in itself – but it is also the best way the dilemmas over ESG can be untangled and reframed.

This report is built on their interviews and recent research findings, discussing the bottlenecks in the system that impede the attainment of purpose and how they can be alleviated.

- **Chapter One** analyses and evaluates the challenges business leaders confront in reporting, executing and imparting purpose – and the necessity of working with stakeholders.
- **Chapter Two** focuses on how asset managers set about stewardship, and looks to resolution of the ESG debate by arguing ESG should be integrated wholly into investment strategies rather than treated in a stand alone fashion.
- **Chapter Three** assesses the critical role played by asset owners, the setting of mandates and the capacity to collaborate more.

The Conclusion and Recommendations wrap up the report, our aim is to help refashion and reboot the case for purpose as a necessary if insufficient precondition for higher investment, growth and meeting those immense societal challenges – and a capitalism that re-earns its licence to operate.

Chapter One: Companies *and Purpose*

Purpose is an inherently long-term concept – its benefits unfold over time. Companies who want to demonstrate how it creates value need to begin by anchoring their reports and disclosure of information around demonstrations of its successful use – and they need to do so consistently and repeatedly. The better they articulate and communicate the benefits, the more they can create a shareholder base aligned with their purpose and strategy. One of the best demonstrations is to show 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.

Declaring a company's purpose is now a requirement under the revised 2020 Corporate Governance Code which together with Section 172 of the 2006 Companies Act creates a potentially powerful framework for not only the reporting of purpose but demonstrating how it benefits the totality of all the company's stakeholders. Companies that have the courage of their purposeful convictions have the legal and regulatory framework at their back both to launch purposing their organisations and releasing the hard and soft information that will explain and support what they are doing. They can now do a lot to make their own weather, sure in the knowledge that the legal, cultural and best governance practice requires just that. **CEO Sir Nigel Wilson** explains **Legal & General's** approach, emphasising the importance of a track record of success based on its purpose:

> *"We've got a multi-year track record now and great momentum. We have this very long-term view and long-term goals and we're on track for all of that. I did get some grumpy shareholders complaining about the purpose and strategy when we began, but when they physically see the transformational difference to places, then that evidence allows us to state it's a good thing to be a purpose-led organisation. It works. Even in the middle of the Covid crisis we paid over £1 billion dividend".*

Research supports the benefits of getting reporting right. One group of researchers finds that companies with a longer-term focus in their interaction with shareholders tend to have a larger proportion of long-term shareholders, while those that focus mainly on short-term results in earnings calls tend to attract a more short-term oriented investor base.[1] Purpose is typically more strongly articulated in those publicly listed companies who have earned long-term investors and are associated with improved performance, finds another study.[2]

But the possibilities are not being seized as properly as they should. The Financial Reporting Council (FRC) reports 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 – which the FRC regards as a minimal position for a useful purpose declaration. A further 18% got some of the way there. But the balance fell well short, with 22 % having a purpose statement that was so vague it was close to purposeless.[3]

1 Brochet, Francois, Maria Loumioti, and George Serafeim (2015) "Speaking of the short-term: Disclosure horizon and managerial myopia" *Review of Accounting Studies* 20: 1122–1163

2 Garternberg, Claudine and George Serafeim (2020) "Corporate Purpose in Public and Private Firms", Harvard Business School Working Paper no. 20-024".
Harford, Jarrad and Ambrus Kecskés and Sattar Mansic (2018) "Do long-term investors improve corporate decision making?" *Journal of Corporate Finance* 50: 424-452

3 HSBC (2021) "Governance in focus: What is the value of corporate purpose", *HSBC Global Research*

Quality of purpose statements from FTSE 350 companies

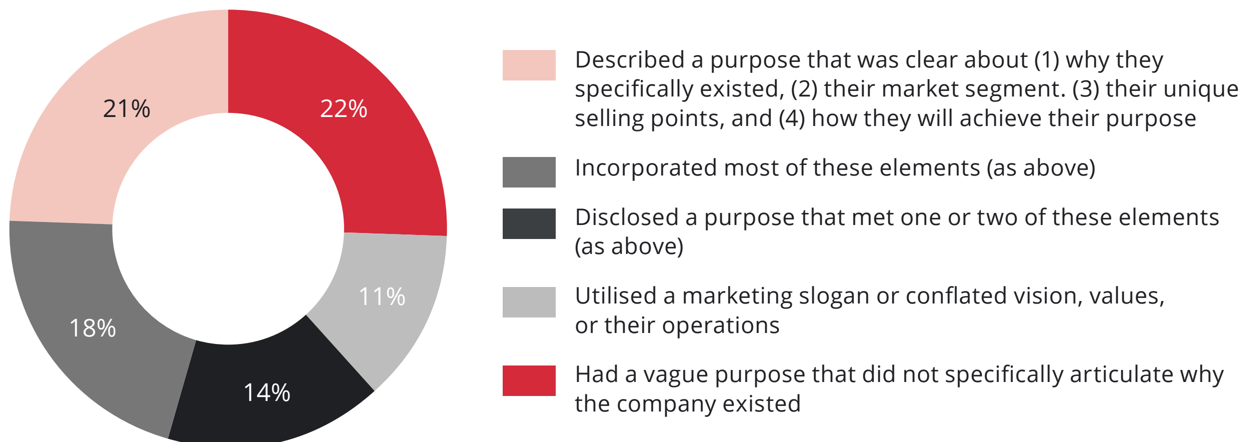


Chart refers to the 86% of companies that disclosed their purpose statement

Purpose is a non-financial KPI, so it is not alone in being poorly communicated. Of the nine KPIs which FTSE 350 companies typically report, four are non-financial; but again the FRC finds only 30% provide insight into their linkage to strategy and purpose, including a clear explanation as to why those performance indicators are the best metrics to use in order to measure delivery against strategic priorities. These failures are fundamental, for as the FRC says, getting purpose right should be at the core of a company and requires careful consideration and judgement about both implementation and communication – which is not being done sufficiently. It sets out what it considers to be gold-standard:

> *"A purpose statement at the core of a company's articles of incorporation requires judgements about balancing the interests of different stakeholders. Once adopted, delivering on corporate purpose requires appropriate structures, systems, processes, financing, measurement and incentives both outside and within the boundaries of the corporation itself. The information on stakeholders' relevance to the business model and strategy, the strength of stakeholder relationships, risks and opportunities, and performance and metrics.*
>
> *When setting out the engagement undertaken and decisions made, companies should disclose the implications of the feedback received, the impact of decisions on relevant stakeholders, and what actions have been taken or are planned as a result. Where the statement highlights issues or concerns raised by a stakeholder, it should be clear how they have been or are going to be addressed".*

Andrew Croft, CEO of St. James Place Wealth Management, sets out how he goes about describing his purpose and accompanying metrics, many of them reflecting the FRC's gold standard. It persuades shareholders that it all makes sense.

> *"Our purpose is 'to give you confidence to create the future that you want'. it's a deep purpose. It's exactly why we're here –*

that strong north star: it ensures we're all pulling in the same direction. So we work in partnership to plan, grow and protect clients' financial futures. The key metrics are the suitability of our advice, the length of the client relationships, the number of complaints that you might get, and how you deal with something when you've got it wrong because we all make mistakes – so it's really important to correct those mistakes properly. So that's the 'what'.

The 'how' is by doing the right thing, being the best version of ourselves and investing in long-term relationships. These metrics feed back into the purpose so that enduring client relationships are at our core. We've always focused on retention; our average client relationship, bearing in mind we've been going thirty years, is fourteen, fifteen years. We're not a transactional based business – we're very much a relationship based business. One of the attractions from a shareholder point of view is our clients stay with us. But purpose also makes us more attractive to retaining employees and our client advisers – who are self-employed by the way. They are bound together by sharing our purpose. The whole thing makes total and utter commercial sense, let alone being the right thing to do".

Investors value forward looking material information. Companies' capacity successfully to horizon scan to assess which environmental and social issues will become material over time; integrating these perspectives into strategic decisions thus becomes a crucial asset.

The concern is that as matters stand the majority of purpose statements are too vague and aspirational, lacking substance and useful mechanism for accountability – reflecting the journey many companies are still on, even those who are committed to purpose, in turning it into a proven mechanism for value generation. They certainly do not provide useful forward looking material information. One study finds that too much reporting tends to be backward looking, consisting of lagging indicators, or worse, tends to the boilerplate. The materiality of what is disclosed is frequently inadequate (see Appendix at the end of the report).[4]

Other investigations confirm the trends. Thus PWC (2021) finds that only 37% of companies explicitly describe a strategy with forward looking information in their Annual Review of Reporting Practices in the UK's FTSE 350. Critically information most would consider useful.[5]

Global evidence paints a similar picture: in 2017 44% of the constituents of MSCI All Country World Index (ACWI) who issued annual guidance looked ahead only a year. A mere 8.7% of its constituents issued longer term guidance for periods greater than one year. Interestingly financial, real estate and communication companies were the worst performers – utilities and energy with necessarily a longer term outlook tended to offer guidance beyond a year, but still the overwhelming majority even in these sectors did not go beyond a year.[6]

The aversion to offering long-term guidance bears heavily on the increasingly live debate over materiality.

4 Kotsantonis, Sakis, Christina Rehnberg, George Serafeim, Bronagh Ward and Brian Tomlinson (2019) "The Economic Significance of Long-Term Plans", *Journal of Applied Corporate Finance*, 31(2), 22-33

5 PWC (2021) "Reporting on a changing world", *PwC's Annual Review of Reporting Practices in the FTSE 350*

6 FCLT Global (2019) "Driving the Conversation: Long-term roadmaps for long- term success"

A growing number of investors want companies to offer guidance on what they consider – beyond what they have financially reported – to bear materially on the trading of the company. Some 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. This is double or dynamic materiality.[7] Investors and companies alike in a range of industries – the oil majors with fossil fuels, drug companies over drug pricing, data giants like Facebook over data privacy issues – have learned that what may not seem material to the business model in one year can just a few years later so jump in salience because of stakeholder and societal pressures, that the resulting regulation, fines or reputation loss can even threaten the business. Thus ethical drug marketing (referencing the 'S' In ESG) famously moved from the margins of concern to become a key driver of profitability and valuation as the opioid epidemic flooded and decimated communities across the US. Pharmaceutical companies were ensnared in lawsuits and investigations. Suddenly what had not seemed financially material a year or two earlier had become a business imperative.[8]

Dos and don'ts in disclosing information

The CEOs we interviewed all expressed a desire to set out longer term plans that flowed from their purpose and to disclose material information – and had a track record of so doing comparatively successfully within the regulatory constraints.

However, investors and companies alike are aware of the risks of disclosing commercially sensitive information and above all the need to walk the tightrope between offering and receiving detailed forward guidance on material issues and toppling shareholders into becoming unwanted insiders unable to act on the information because it would represent insider trading.

There is a special obligation on purposeful companies to offer as much forward looking guidance of matters they consider will become potentially material – after all they will rely on their purpose to help navigate challenges and seize opportunities. **Alison Rose, CEO of NatWest**:

> *"I do around a hundred meetings a year. I write to my investors and if they want to meet with me I'll meet with them whenever they want. I will always give them clarity and spend time with them, obviously within the boundaries of strictly giving them forward guidance. They're our long-term partners in the business so they should have as much access as they want, so I'm very happy to do that. We have a very clear strategy. We have a very clear set of outcomes that we're tracking our progress to – climate is a good example".*

Her long-term plan – and annual stepping stones – are crucial to her story:

> *"We're saying this is the ten year view, but in the next year we're going to do this, this and this. I've got clear financial targets that set a clear trajectory and I report on progress. We believe a purpose-driven strategy aimed at delivering long-term sustainable value also delivers annually. So it's just being very clear and transparent about what we are doing and what we're not doing.*

7 World Economic Forum (2020) "Embracing the New Age of Materiality: Harnessing the Pace of Change in ESG" White Paper

8 Keefe, Patrick Radden (2021) *Empire of Pain: The Secret History of the Sackler Dynasty* Picador

Investors then have to decide if that's a story they want to buy into, but being very open and clear with very clear targets and delivering on them so that we're executing our plan.

When an investor is chasing short-term quarterly returns, it's a more difficult conversation. But I'm still delivering quarterly value – delivery of those quarterly targets and annual targets gives investors the comfort that you're on the right path. I recognise that some of the other purpose elements are less interesting to some of those analysts, so it's really making sure you understand your investor base and what matters to them".

Peter Pritchard, CEO of Pets at Home (until May 2022), is a similar fan of maximum transparency.

"I think you choose to be one of two things. You either choose to disclose as little as possible – there are many organisations that don't disclose an awful lot at all, and then it becomes a dark art. Our attitude is to disclose what's really important to make things transparent. At difficult times actually it's much easier to navigate. So rather than not disclosing our trade secrets it's best to help investors understand what matters and what's important, and how we think and how we operate. Ultimately investors do two things. They're investing in the business but they're also investing in the management and reputation that you create. In my experience the more transparent and honest we are – the more we say things as they are – you generally get better engagement because they believe you.

The great thing about Pets is we say one thing and then reporters can turn up and say did we do it. You earn your reputation by never surprising. Even when it's bad news, you manage it, you are transparent on it".

Sir Nigel Wilson aims for the same candour, driving his points home by showing investors what Legal & General is doing on the ground:

"We prefer to demonstrate our work visually, on the ground. When you look at the physical progress and difference we can make, it creates a tremendous emotional bond between us and our shareholders. A piece of dry statistics on stuff – say we've moved from 27 to 32 on this particular matrix – just doesn't do the same thing for investors as witnessing the physical progress. To see the million square feet we built in Cardiff, that we did transform Salford, what we are doing with the old AstraZeneca site, our housebuilding programme, Podpoint our EVcar charging business or the Helix in Newcastle which is amazing on the old Scottish and Newcastle site. It's all physically there.

We've got hundreds of real case studies like that, so we've never ever been accused of being woke. We do test ourselves. We set up a team to look at it

seriously – from a greenwashing point of view alone – to make sure that if somebody comes into the organisation, looks round, talks to people, meets people, does interviews like this, we can then test to see whether or not everything we're doing is what it says on the tin about being a purpose-led organisation. Nobody's ever doubted that".

Liv Garfield, CEO of Severn Trent, sets out her approach – again rooted in evidence:

"It's a presentation then Q&A. I'll do a set piece to get core information on the table – say I'll present ten slides – with a back-up slide deck to address particular questions. Investors will have up to fifty questions and we reply to them. Typically, it's a conversation with them going through what they want to ask until they're done.

Different investors come to it from different angles. So some want to look at where we are and why, using varying indices like CDP or UKMCI and the like. Some have already assessed our results and want to talk about two or three areas where they have a concern and they want to delve deep into that.

Others say: 'Ignore today's metrics. What's your big ambition? Where are you going to be in 2030 or 2040?' And they want to go more into that. It doesn't matter what direction the conversation takes as long as you have a strong narrative and robust answer, because the honest truth is that for an active fund manager with so much evidence out there already, they will have their own way of testing measures and reviewing things. They've probably got a very complicated model that is already giving them data. They might ask a few questions but the reality is they've already churned through the quantitative data and don't want more data from me. So a whole chunk of it is around creating belief, crucially offering them the evidence and persuading them that the management team has done – and is going to do enough – to deliver what we've promised".

All our CEOs point to the tangible benefits within the company of developing and communicating a long-term strategy that shows how purpose will be made to live over time. In this they are supported by research: the International Integrated Reporting Council (IIRC) reports that 79% of managers found that business decision making had improved, and 78% experienced better collaboration between the board and management after doing just that.[9]

However, there are reasons why even purposeful companies are uneasy about disclosing too much detail in their long-term plans – and how they read future trends. First, many management teams are concerned about giving away commercially sensitive information about company plans. Second, many are unwilling to

9 International Integrated Reporting Council (IIRC) 2015: "Creating Value: Value to the board"

commit themselves to what they see as forecasts of future performance for which they may be held accountable. Third, they may worry that discussing their company's risks and difficulties in a direct way may scare away investors, though the earlier evidence from the FRC and others we have cited suggests that investors welcome this information given the tendency of companies to focus only on the positives. And lastly there is concern about the tightrope they walk between offering detailed forward guidance on material issues and toppling shareholders into unwanted insiders, unable to act on the information because it would represent insider trading.

Peter Pritchard, CEO of Pets at Home (until May 2022), captures the tensions, saying that investors don't expect companies to be crystal ball readers – but expect transparency and updates:

> *"It's really difficult when you predict the future not to try to lay out things too grandly. What we try to do is to explain the forces at play and what we think as a result we have to do. So for example we're thinking about offering guidance this year on how much energy I'm going to use. Do I know how much energy is going to cost me? I haven't got a scooby doo. It's somewhere between £20 and £40 million – pick a number. I don't know. So what we then try and do is explain the variables that we deal with, otherwise we'll just get it wrong. By being transparent on those, we can actually update constantly. Our investors really warm to that because they understand. They don't expect us to be crystal ball readers and if we're too precise, they become suspicious too".*

ITV, CEO Dame Carolyn McCall describes in her turn how tricky it is to manage forward guidance on material issues. In ITV's case the issue was how to present early in 2022 a vital £160 million investment to shareholders in building the capacity to create consistent high quality digital content in order to compete with the way TV is increasingly watched in the world of streaming services. Her problem was that she could not seed the market with the news, even though it was a development of a strategy rather than a wholly new strategy, because it would have made the shareholders insiders. Some shareholders took umbrage at the hit to short-term profitability and the share price tumbled. She takes up the story:

> *"It would have been easy to have continued for another couple of years getting the margin, making sure that we were cost cutting, eking out the profit. Doing all the things that you do. But we'd have hit the wall at some point because you can't keep that going in today's television market without a strong digital presence – everyone is watching TV in a totally different way. How, we're asked, are you going to compete with Netflix, Disney, Prime, and Discovery?*
>
> *So, the bolder decision was to put £160 million into doing Digital First content – while preserving the overall content budget – and £40 million into technology and data management where we had far too little capacity. We knew we were going to take a lot of heat and pain for an investment of that scale after record breaking profits and not doing a share buyback – the brokers had said the markets will see this as a downgrade and won't be able to look through the 2 to 3 years to breakeven in 2026. But we didn't*

realise how much pain: our share price went down 27%. Clearly the announcing on the fifth day of Russia invading Ukraine was not great, but we couldn't choose the timing.

Although 85% of our shareholders supported us, three or four shareholders were really angry, despite the good relationship I had with them – and on top of that the strategy was in line with our purpose. One asked why didn't you alert us – you've always seeded things with us before, always kept us close, always communicated really well. I had said to the brokers beforehand that I'm most uncomfortable about not having the opportunity really to seed this with key shareholders: that we must spend more money on digital content. Then those key shareholders would have asked how much and I'd have had to say: well it may be a big cost but it has to be made.

However, I wasn't allowed to do any of that, because I would have been giving them share price sensitive information. Once I even hinted at our thinking it would be seen to be insider information. So there was no way I could have brought this large shareholder onside unless they wanted to be an insider. Of course, they don't want that, because then they can't trade shares. It would be brilliant to be able to seed this and say we believe this is the right thing to do, giving shareholders time to digest the information. It was not even a change in strategy: rather a step change in the amount of investment in content in line with our purpose. But still we were unable to offer material forward looking information. I don't ever believe in surprising the market. This was the first time I did it and it was pretty unpleasant. But I don't think there was another way of doing it. There was no way we could have communicated it".

She added on a more hopeful note, that the only answer is to redouble your communication efforts afterward:

"One of the things I learnt from this episode is while we can't give forward looking scenarios, we could indicate potential ranges of outcomes – an upside and downside expressed as a percentage of the baseline – that might make news less surprising. But I think the only answer is to spend a huge amount of time and energy (and rightly so) on communicating after the announcement. Of course, by that time they're cross – asking why didn't we have sight or sound of this before? You can only try your very best to make sure that they understand the rationale of the strategy and its step change – or

whatever else the issue is. And you then have to work much harder and communicate much more about your milestones, your delivery, how you're doing, the digital KPIs. All of those things. The sooner you can show that the return on investment to them is real, the sooner they will re-evaluate you for the better".

Ways forward include offering scenarios with a range of material outcomes, better reporting of purpose so it clearly supports strategy and then, building on this understanding once announcements have been made, to communicate and explain why decisions have been taken as powerfully as possible. **Liv Garfield** endorses the value of communication:

"We had to raise fresh equity the year before last, earlier than expected, and that's hard because no investor wants an unplanned equity raise. We were doing it for the right reasons: we had a growth opportunity because Ofwat permitted us to grow our Regulated Capital Value – our asset base – by £650 million under a 'Green Project Award'. But in order to do it we had to show willing immediately rather than wait, which meant investors were going to have to shoulder some of the financing – £250 million. It's a moment when people need to back you – because if they don't the share price will drop because you are diluting their stock.

We explained in a really effective presentation why the investment needed to go forward, why we were placing shares but also how our purpose drove the organisation, the culture and the long-term vision – which we pitched to all our investors. And the share price actually went up which is counterintuitive.

They were backing us as an act of loyalty. If you've delivered well over the last six years as we have, they trust your judgment. Moreover, it was a green project, affirming our commitment to promoting water supply resilience, smart metering, good bathing water, removing lead piping and the like.

So we offered investors a win/win – doing the right thing environmentally and getting a good investment return which kind of catches the moment. And lastly, we were very precise on why we were asking for these things in this manner and then how we were going to deliver them. It wasn't 'Give me some cash and we'll work out what to do with it' It was tangible. They knew they were contributing to something real".

Shareholders have their role to play in wanting to engage and to use information about purpose constructively. **Andrew Croft** finds that questioning about purpose and material risk is still the preserve of a minority:

"You've got some very long-term shareholders that are buying the shares for the long term. When you have meetings with those, they don't ask about financials at all. They are asking about culture, they are asking about purpose, they are asking about

regulatory risk etc. etc. You obviously have the trackathons – the trackers – which are becoming a bigger and bigger part of share registers: you tend not to have too many meetings with them, when you do the focus tends to be around governance coming up to an AGM and a vote. You're going to have some shareholders that are medium term; they might see that the shares are a little bit beaten up at the moment and they're just checking. They're understanding; they're going to come in but they're going to exit as the shares recover by 10% or whatever their target numbers. And then the final category of shareholders is the very transient. They're in and out very quickly and those meetings are all about very short term, very specific points. They want to get into what's in cell 1A of their model because if cell 1A moves, then maybe they could buy or sell the shares quite quickly".

Dame Carolyn McCall echoes his frustration:

"When I was running easyJet I've heard a shareholder (who was fairly unreconstructed it has to be said) ask why is your workforce so happy? Ought you to be working them harder? I swear this is a proper blue chip institutional investor. And I laughed. He said I'm not joking. Ultimately, we had a fantastic relationship and I replied: I can't believe you've said that – I'm absolutely gobsmacked. And he repeated: what are you all doing being happy? So, I think a lot of institutions talk a good game about purpose. But honestly, I don't think they invest on purpose. I think they might invest if they value ESG a lot: the companies who are doing that well are more investable than companies that are not doing that well.

But in the main it's not what they really care about. They might in the round get the purpose and say, for example, what you did about Britain Get Talking or on mental health was fantastic, but they look at numbers – number 1 and strategy – number 2; and to the degree purpose is part of strategy, then yes but purpose is not front and centre".

Liv Garfield also thinks shareholder commitment to purpose is variable:

"Attitudes about purpose and ESG vary amongst our investors. Some are very interested but I can't claim they are the majority. Certainly in my top thirty I've got two investors who are pure ESG, and wouldn't come in if I wasn't purposeful – doing the right things for the environment and society. We've definitely been able to convince some people that purpose drives our investment and delivers really good returns. There are even investors, like Aviva, who've opened a dedicated fund

focused on investing in purposeful companies and chosen us as one of the founding companies; but there are other investors who look purely at numbers and simply need exposure to the sector as much as anything else. They are pleased our numbers are good, but probably a little less clear on why. So while the investors who are much more focused on our purpose and ESG commitments are much clearer that what we've delivered isn't transient and will stick, the investors who focus more on the numbers wonder whether somebody else could catch us up tomorrow".

Nicholas Lyons, chair of Phoenix and on sabbatical to the Lord Mayor of the City of London, expresses frustration at the way investors value companies:

"Businesses have moved on from the Friedmanite pursuit of shareholder value expressed in purely financial terms. For real long term value to be created, it needs to be looked at through a number of different lenses, such as environmental and societal as well as financial. Conventionally, using discounted cashflow analysis, the majority of the value of a cash-generative company would be derived in the period where specific annual cash flows have been projected (usually ten years) and the terminal value (relating to the period beyond the projections) discounted to the present day might be, say, one third of the total value. That is because investors are more sceptical about those future cash flows. In a genuinely sustainable business, however, I would argue that the majority of its value should be in its terminal value. But this is not the approach of most of those assessing what a company like Phoenix is worth: there is a disconnect between how fund managers look at short-term, visible cash flows and the long-term value that is deeply embedded in the purpose of companies. This is even more the case when you look at, for instance, technology or biotech companies that are not yet cash-generative. And that's a conundrum".

One crucial way of both doing purpose and selling its benefits to shareholders is to enlist the Chief Financial Officer and the Finance Team.[10] They can play a critical, if underappreciated, leadership role thanks to their organisational network and detailed understanding of data, processes, targets and reports. The CFO team has the professional toolkit to align purpose issues with the company's financial goals and speak in a language that the capital markets intuitively understand. **Dame Carolyn McCall** again:

"The CFO is critical. I think if you don't have the CFO's buy in there's actually no point in trying to start doing purpose. Because what will happen is you either change the CFO or you accept the CFO's prohibition and don't do it – the finance department can block things every which way they want. They can be very obstructive. It's never happened to me but it can happen in companies – you hear of

10 Accenture (2022) "Measuring sustainability. Creating value Time to rethink performance and redefine success"

> *that happening. So there is just no point starting it unless you have a fully aligned CFO".*

The reality, as Dame Carolyn McCall acknowledges, is that many CFO teams do not have the appetite to take on this role – and even those that do may not have the skills. Although the finance role is integral, the lead has to come from the top – Chair, CEO and the entire board with a bought-in CFO. **Liv Garfield** is confident that this need is increasingly recognised, as is the need for purpose:

> *"In the next cycle of refreshing FTSE 100 chief executives, I think it will be very rare to appoint somebody who isn't purpose led. Investors will insist that's the type of CEO they want. Private equity will lag because there's no similar pressure to change.*
>
> *If you look at the behaviour of most investors now, they have very strong ESG preoccupations – take for example BlackRock who is invested in almost everybody. I don't go to a meeting with any of my top thirty shareholders where there isn't a dedicated ESG analyst in the room – all part of the process of foregrounding ESG. If I was to resign tomorrow, one of the qualities they will look for in my successor is whether he or she would continue where I have left off. This is not going away: it's accelerating ever faster in listed companies".*

Reconciling ESG and purpose – towards a new compact?

Liv Garfield is right. There has been an explosion of investors with ESG preoccupations – as remarked in the Introduction on some estimates as much as a third of the funds under management in the UK are now earmarked as ESG. But with growth comes ever more critical scrutiny of the integrity of the practice of ESG investing – and the quality of the information disclosed by companies.

The speed of its rise has taken the system off guard, for within the fast time frame of its ascent no common framework has been developed for assessing how ESG is measured, ranked and delivered across a range of very different companies. It is hardly a surprise that without this consensus there is a spectrum of views about what ESG means and whether as currently practised is achieving any good. Indeed, there are charges that – given the substantial differences between which firms are doing it well and which are not, reflected in very different metrics awarded by the credit rating agencies – has created an open season for at best misleading investors and at worst actively traducing them with 'greenwashing'. On top, as identified in the Introduction, there is wider criticism that this is a bridgehead to 'woke capitalism'.

ESG metrics do have severe methodological limitations. Individual credit rating agencies disagree substantially over a company's ESG performance. For example some of the largest firms in the world – GSK, L'Oréal, BT, Goodyear, Samsung – are scored very differently by different rating agencies – see the table below showing divergence in ratings across large US companies.

Divergence in ratings across large, US companies

Source: Divergent ESG Ratings by Elroy Dimson, Paul Marsh and MIke Staunton, Journal of Portfolio Management Nov 2020

The table above shows the divergence in ESG assessments on six major US companies. Another paper finds that the correlation between ESG ratings is, on average, a poor 0.54: but there is a much better correlation between the two market leaders – Moody's and Standard & Poor's – where the correlation is greater than 0.95.[11] The reality remains: one agency's A+ is often another's laggard.

There are good reasons for these sometimes extraordinary divergences in how ESG metrics are defined, measured and then weighted by company.[12] There is the sheer variety and inconsistency of the data and measures, and of how companies report them. This is particularly true of the social category: for example, there are more than 20 different ways that companies report their employee health and safety data – inconsistencies that lead to significantly different ESG scores. Then there is the problem of identifying appropriate peer group comparators cum benchmarks: lack of transparency among data providers about peer group components and observed ranges for ESG metrics creates market wide inconsistencies and undermines their reliability. Where there are data gaps, ESG researchers and analysts have to impute what is happening sometimes creating huge discrepancies. And lastly there is so little agreement that even disclosing more information does not seem to narrow the differences.

All this has led some to dismiss ESG completely as intellectually incoherent and in reality virtually impossible to find practical bases for measurement and comparison. One obvious impact is that some investors are growing more hesitant about investing in ESG shares,[13] and the uncertainty reaches beyond the investment world to the wider public. However, the view of **Sacha Sadan, Director of ESG for the Financial Conduct Authority**, is that while there may be difficulties and pushback, that is only to be expected of a concept that is coming

11 Berg, Florian, Julian Kolbel and Roberto Rigobon (2022) "Aggregate Confusion: The Divergence of ESG Ratings", *Review of Finance*, https://academic.oup.com/rof/advance-article/doi/10.1093/rof/ rfac033/6590670

12 Kotsantonis, Sakis and George Serafeim (2019) "Four Things No One Will Tell You About ESG Data", *Journal of Applied Corporate Finance*, 31(2), 50-58

13 Avramov, Doron, Si Cheng, Abraham Lioui and Andrea Tarell (2021) "Sustainable investing with ESG rating uncertainty", *Journal of Finance*, 145(2), 642-664

of age and joining the mainstream. Finding metrics is not impossible. He shares the opinion of Liv Garfield: the demand for ESG, whatever its current weaknesses, is not going away.

> *"We have to unpick what ESG means because there are lots of things inside there. It's huge, I do think people have probably over-promised with some of what they've been saying, but that is just part of growing up and moving into the mainstream. I don't think that this is a crisis. This is just part of the process and we'll get better at it when we do define these things and explain them better. I've been an investor for a very long time before my current job and investors care about these things. Equally employees are not going to suddenly stop caring about, say, the diversity in their firm or whether it is a good place to work. These things are inherently inside firms and they're not going to go away. The current debates are just part of the growing up and becoming inside the mainstream".*

He dismisses the charge that ESG is too sprawling or that some elements like the environment are easier to measure than others so making the S and G softer and harder to rank.

> *"Oh God No! Of course, for all the reasons we know, climate has taken a lot of the room. Carbon emission reduction and net zero plans are very important, but they're not the only thing in the room.*

> *The 'S' is extremely important and there are absolutely many things that you can measure in the 'S' space. Take supplier payments. You can now look on a website and find out how long a company takes to pay its suppliers. Good companies are members of the prompt payment code. Then there is the living wage: it's easy to sign – but have you signed up? It isn't just about paying your employees, it's paying your contractors, support staff and the whole eco chain. So there are metrics in many of these areas.*
>
> *Governance is one that we've been on for a while. Investors have been pretty good at trying to have chair/CEO splits, rotation of boards, to require an audit committee and health & safety committee for example. Investors have demanded that there are checks and balances at the top. So the 'G' is the most advanced of the three.*
>
> *Of course there is pushback, but this is about the business of investing. Most of the asset managers and asset owners are talking about ESG not because of nice fluffy things, but because they want to make sure that they're pricing the risks that they think will affect their money. We just talked about the 'G': you do not want the tail risk of G blowing up if you're a bond investor – you're only going to get your coupon back.*

So what is our job at the FCA? The chair of the US Securities and Exchange Commission, Gary Gensler, has said 'I just want people to have the disclosures they need before they make investment decisions and some of them may include climate disclosures.' So that's how it works. Of course there will be a reaction which I've seen many times before – but this is not going away".

There has to be some resolution. Companies may chafe that too few shareholders want to talk about purpose and how they can best present ESG effectively to their shareholders for which there is shareholder pressure – but they recognise that both have to be done. Equally asset managers simply have to respond to the clamour of their ultimate beneficiaries' call for action.

Alex Seddon, head of Catalyst, M&G Investments', impact investing arm, captures the pressures and necessary responses well:

"Our clients want us to get good financial returns but increasingly they also want their personal investments and retirement savings to be invested in businesses that are contributing to improvements in areas such as Climate, Health and Social Inequality. I don't think a business like ours, or any other business, should be saying that purpose alone is everything. Rather we should be saying 'The client is everything so what does the client want?' And if the client also cares about purpose, then so should we, and we should invest in a way that is aligned. Our job is to express that purpose through the mandate under which we are investing. In that sense there is very clear purpose. It's reflecting and expressing what our clients want".

Whatever the controversies swirling around ESG, our interviewees shared Sacha Sadan's opinion that the pressures for ESG disclosures would not go away – and should not be allowed to muddy the waters over purpose, a much larger concept than ESG. Purpose addresses the 'why' of a company – its intrinsic reason for being – and just as it developed before ESG emerged on its current scale so the 'why' will continue notwithstanding into whatever form ESG eventually transmutes.

ESG reflects how a company chooses to reflect particular demands to show awareness of environmental, social and governance concerns.

The practical resolution was that given the difficulties over ESG measurement, companies were taking over the ESG narrative themselves and presenting ESG data in their own terms and within their own statements of purpose. Some of the resulting particular ESG policies may reflect dimensions of its purpose, but they should not be confused with it. However, when it comes to developing metrics many companies have found it useful to identify elements of ESG, especially if they have developed metrics for their measurement, as congruent with dimensions of their purpose.

Thus **Alison Rose** uses measurable climate commitments, part of NatWest's ESG commitments, to embody her larger purpose:

"Purpose provides our strategic sense of direction. We've picked three focus areas to represent our purpose where we think we can make a difference and add value in terms of building that long term, sustainable value. So we picked climate, we picked education and learning and we picked enterprise.

Banks and large organisations have always had ESG policies but they're run by a sustainability team or marketing team. One of the first things I did was to make dimensions of ESG, like climate, a strategic priority, then it becomes embedded in the business objectives and drives our purpose.

Purpose has got to drive to outcomes. So if I take climate as a specific example, we think that's very clearly a business opportunity. If you're going to transition to a low carbon economy, you're going to need trillions of dollars of global investment in order to be able to do that. We did some research for SMEs in the UK called Building a Sustainable Recovery and we think there's a £130 billion revenue opportunity for SMEs by embracing a transition to a low carbon economy. Seizing that opportunity is thus living our purpose".

For her, climate change is a pivotal strategic business objective that embodies NatWest's wider purpose. It is a commitment with accompanying metrics so that her plans can be measured and shown to be financially material now and in the future – and thus that she is meeting NatWest's purpose.

Dame Carolyn McCall adopts a parallel approach at ITV:

"We do a social purpose report which is our core purpose report every year. We circulate it to all our stakeholders here and some internationally. It reports on all the pillars of our social purpose and how we're doing against our commitments on screen and off screen. One of our key social purpose goals is mental health. It dovetails very much with our core purpose as a public service broadcaster.

So an important metric is about how many people we get to use the helpline for mental health. How many people phone the help lines? But we go a bit deeper than that to ensure we are having a positive impact. Our key metric is how many actions people take as a result of our campaign to look after their mental well-being. We survey viewers to find out how many take an action, like connecting with one another, after Ant and Dec launched the campaign.

We obviously have our climate change metrics: we incorporate these in our programming and we will be a net zero company by 2025. Those are very galvanizing internally for stakeholders and frankly externally they are imperative as a minimum hygiene factor.

We have a whole dashboard on diversity and inclusion – KPIs to ensure we have more black and disabled senior leaders, doubling our intake of

people with disabilities. Those are three big things on which we focus. ITV is for all. It always has been. It's always been stronger in the North and on social mobility. Like Alison at NatWest, I think it's smart to make these purpose commitments a core part of the business strategy. If we do these things really well we're reflecting Britain better – our purpose as a public service broadcaster".

Liv Garfield sees ESG as a terminology she uses for investors. Internally she talks about its components which are more real and understandable in terms of Severn Trent's purpose:

"ESG is a terminology I need to use to investors because ESG is an investor terminology. Internally we wouldn't talk about ESG: it's just not the way we run the organisation. We talk about the environment, about communities and about our people. We bind all that together on the basis that we're delivering a purpose, but we wouldn't use the ESG term internally".

If this is the way ESG is being pursued by companies, it is paralleled by the investors we interviewed – of which more in the next chapter. ESG should be cast simply as a way of informing sustainable, mainstream investing. **Romain Boscher** captures the consensus:

"We have made two choices. First to consider that ESG was mainstream and not transitory, and secondly to have our own proprietary ESG ratings and not to rely on backward rating coming from a rating agent. In effect we were building on what we were already doing with what we used to call our red flags for long term winners – companies with a deep culture of purpose that we felt must grow.

It's now better formalised, but I wouldn't say quantified because purpose is something quite difficult to quantify. Data cannot capture everything, precisely when you are talking about purpose. You cannot say "My purpose is ten points here or twenty-two points there". So we've intentionally made the choice to think ESG and to exercise discretion. Even when it's about ESG, we are still remaining partially judgmental, because we are willing to capture this notion of future purpose".

Stakeholder engagement

Engaging with stakeholders is decried as woke – yet there are two big practical reasons for leadership teams to engage stakeholders over purpose. The first is to close knowledge gaps. The material risks that threaten a business model emerge dynamically while most contemporary value creation processes are so knowledge intensive and complex that no single individual or group of individuals – including the firm's founders, officers, and directors – is likely to possess the relevant information to respond to all the challenges.

Stakeholders offer a source of all-round, deep and often insightful knowledge of the firm from beyond the C-Suite. This is particularly true for risks, opportunities and likely developments that are at the margins of current thinking and planning. **Andrew Croft** sets out how he sees the importance of managing his six principal stakeholders – a six-legged stool that mustn't fall over.

"It's like a six-legged stool because we've got six principal stakeholders – clients, partners, employees, shareholders, regulators and society – and what we've got to do is make sure that that stool doesn't fall over. There is always going to be some kind of trade-off there but it's such a huge symbiotic relationship, it's almost unreal. If we don't address certain things then that's going to impact client and employee sentiment. You lose employees, you lose advisers and it's all inter-related. So it's really important to keep that stool upright – to keep all stakeholders in some form of equilibrium, particularly for a long-term business. We've got long enduring client relationships and the longer those relationships last, then the better it is for everyone. It's really important to look after all individual stakeholders".

Sir Nigel Wilson stresses the value of purpose to dynamising and engaging his workforce:

"People want to work for a purposeful company, and we're very much a purposeful company which is why people want to be here. They can physically see good things happening and be proud. Having a brilliant quarter or whatever isn't as motivating for people as being part of the team that transforms a city or develops a new saving platform as part of a larger purpose. I think the dream of creating an asset class of purposeful companies is a good dream – the more companies who openly and publicly share this approach the better".

The second reason is that purpose, properly pursued, is serious – and everyone involved needs to own the seriousness of intent. **Liv Garfield** echoes both that need and the beneficial results of enlisting that enthusiasm.

"The biggest immediate impact of purpose is to get everybody aligned behind something bigger than them. People want to work somewhere that's doing something worthwhile – it helps not only us to retain good people but motivate them. Although as a utility we have a revenue cap, about twenty percent of our profit per year comes from service performance. And we genuinely believe that our outstanding service performance – typically we out-perform the sector average by ten times – is based on the fact our people and our culture are so committed. They want to do more for the company.

There's incredible loyalty to the organisation based on how we run it. On top you get better investors that help management make better long term decisions and that breeds leaders who think long term strategically rather than the next one to two year cycle. So yes, purpose drives commitment, loyalty, performance, good strategy and profitability".

The most obvious stakeholder with which to engage is the workforce – as both Liv Garfield and Sir Nigel Wilson observe. The revised UK Corporate Governance Code 2018 requires that boards, to enable workforce engagement, have either a director appointed from the workforce, a designated non-executive director (NED) or a formal workforce advisory panel – or explain what alternative arrangements are in place and why they consider them to be effective. Companies could and should take this obligation more seriously: it is an important avenue to bottoming out and grounding purpose. The FRC (2021) did find that 68% of firms in its sample adopted one or more of these options as a direct consequence of the Code, but what the balance are doing – and indeed whether even those that comply with the Code know what they are doing and why – is not clear.[14]

British business culture tends to be suspicious of formal employee engagement, especially if it involves creating formal channels of the type called for by the Code to express employee voice – directly or indirectly empowering organised labour. However the survey evidence is that worker directors all play a valuable role, engaging fully in board deliberations and discharging their legal duties without issue, as well as honouring the trust placed in them with confidential information.

Jon Lewis, CEO of Capita, for example is a passionate advocate of making employees directors: it adds to the knowledge base of the board but also educates employees and he has practised what he preaches with two employee directors.

NatWest does not go as far as Capita; instead a non-executive director chairs a "Colleague Advisory Panel". However, **CEO Alison Rose** stresses its importance:

> *"We don't have colleagues on our board but what we do is we have a Colleague Advisory Panel which is chaired by one of our non-exec directors. It is a forum for our colleagues to critique the board, critique the team and share their views with us, It is a very active panel. We have a Junior Management Team which is a shadow of my executive team selected for talent – sort of effectively the equivalent level of my team at a lower level – that we share board papers with, and who sit on a rolling twelve, eighteen-month programme and review our comms and get involved in different initiatives from that perspective.*
>
> *We have a very active employee led network programme which I chair, and I meet with them every quarter and they come to our board. We have a multicultural network, who produced a report last year called Banking on Racial Equality which is a ten-point plan to help address some of the issues that were driven by Black Lives Matter and the issues facing black, Asian and minority ethnic groups across the UK. It has programmes for communities, for customers, for colleagues and suppliers, driving into that.*
>
> *Importantly purpose is in our governance. We have a Culture Programme which is part of all of that and it's also part building into the executive remuneration. So for example climate is now part of executive remuneration as well. So we're weaving it from front to back through our organisation, through our governance rather than being just something we talk about".*

14 FRC (2021) "Workforce Engagement and the UK Corporate Governance Code: A Review of Company Reporting and Practice"

In Europe in general there is a far more systemic approach to worker involvement than the mild proposals of the UK Corporate Governance Code, with Germany famously having a well-developed system of co-determination with employees sitting on supervisory boards. However, the evidence both for major benefits – or major costs – is scant. Rather the micro-evidence points to a range – from small positive net effects to little that is discernible – and certainly nothing negative.[15] However active employee involvement does, at the very least, signal that employers welcome and are ready to accommodate employee views.

For **Dame Carolyn McCall** there is only one sure fire route to find out what employees think and garner their input – to walk the floor and talk to them.

> *"There's only one way of really finding out what staff think properly, and that's going out to see them. No question in my mind. When at easyJet I would fly on the plane I would do the rubbish with the crew. I would sit in the galley with them and have a cup of tea at the break. I would go into the crew room. I'd talk to captains. I would go to the engineers late at night. And I would really find out what was going on.*
>
> *I do the same at ITV. And that's what I think Covid has really disrupted. I did a vodcast every single week through Covid as my substitute for going out and seeing people. I talked to people and interviewed them – there'd be a panel – and then an anonymous Q&A. I didn't know where the questions were coming from. They could be as obnoxious or as difficult as people wanted, but they could ask questions. It was one of the things that people said afterwards kept them connected to ITV.*
>
> *On top we have ambassador forums. We have Embrace – the black Asian minority ethnic network. We have Able which is a disability network. On top there is Pride and the Women's Network. And I go and see representatives from them on a regular basis because it's the only way I really know whether we're making progress".*

Workers, though, are only one stakeholder group – other key components are customers and beyond them society at large. A number of companies have established advisory councils as a bridge from companies to consumers and society, while others have gone further and created external stakeholder panels in their formal governance structures to provide support to boards on evolving customer attitudes, help with stakeholder relations and to offer direct feedback on pressing purpose/ESG topics.[16]

EDF Energy in the UK, for example, created a stakeholder advisory panel from 2005 to 2017 which CEO Vincent de Rivaz believed played a key role in building stakeholder and political links to enable the building of Britain's first new nuclear power station for thirty years at Hinckley Point.[17] Federated Hermes has a Client Advisory Board in which ten clients feed back opinion and ask questions

15 Jäger, Simon, Shakked Noy and Benjamin Schoefer (2022) "What Does Codetermination Do?" *ILR Review*, 75(4), 857-890

16 Morrissey, Daniel (2021) "The Promise of Stakeholder Advisory Councils", 23 J. Bus. L. 470 (2021). Available at: https://scholarship.law.upenn.edu/jbl/vol23/iss2/4

17 Vincent de Rivaz, (2023) We Need Power Don't We, Telemaque

of the firm's leaders and strategy. Facebook has established an independent Oversight Board independently to verify its approach to content regulation and offer adjudication in disputes. In France the approach is legally enshrined in the entreprise à mission status. Companies are required to establish a *'mission committee'* to assess whether they are fulfilling their purpose which, in turn, is verified by an independent third party.

British utilities, particularly water companies under pressure about quality of delivery and their responsiveness to consumer concerns as monopolies providing a public good, have developed Consumer Challenge Groups (CCGs) to give consumers a more active voice. CCGs have delivered a number of benefits, particularly in the way they have helped shape companies' customer engagement programmes and pushed utility companies to reflect consumers' views in their business plans. There is scope to strengthen CCGs further through better national coordination – e.g. the creation of a Central Oversight Group (COG) that would provide comparative information and analysis to local groups. Such a national body would also have an important role in challenging the development of the collaborative national research.

Indeed a number of companies in the water industry, including Severn Trent, capture this approach to consumers as part of an encompassing approach to promoting social purpose as public benefit companies. **Liv Garfield**:

> *"The best companies have values that go well beyond short term financial self-interest. Companies that deliver excellent performance and contribute to broader environmental and societal goals are far more likely to maintain the trust of customers, be able to recruit the best employees and attract long-term investors – in short, they are far more likely to be commercially successful in the long-term. We call this approach as being 'socially purposeful' – and it is something to which we can directly trace much of our success in recent years".*

Stakeholder engagement is not only a matter of information gathering – it is crucial to embedding purpose within the organisation. It has to be lived daily rather than imposed top-down. No matter how well intentioned, companies will struggle to be purposeful unless they flatten hierarchies and give lower level employees and managers more autonomy (as well as fostering collaboration across functions, business units and geographies).

The relationship between purpose, decentralisation and autonomy is multi-dimensional. First it helps build trust and thus embed purpose into an organisation – when employees encounter autonomy on the job, they value the fact that they are being trusted and come to realise that their management is not like others: it views the company as more than just a nexus of contracts between self-interested individuals. In turn, purpose fosters trust, enabling higher levels of autonomy and collaboration that facilitate the adoption of these types of organisational structures. Finally, purpose is not just an organisational phenomenon: individuals also have their own visceral sense of personal purpose – not necessarily aligned to the organisation's. By being granted more autonomy within guardrails set by purpose, employees are able to attach deeper personal meaning to their work so that they inject even more of their passion and exuberance, resulting in better performance.[18]

Andrew Croft attests to the value of staff believing in your purpose – especially at crisis moments when firms have to retrench and launch redundancies:

18 Gulati, Ranjay (2022) *Deep Purpose: The Heart and Soul of High-Performance Companies*, Harper Business

> *"We went through our first ever redundancy programme a year ago and that was really tough. We needed to make sure that those people who weren't being made redundant could see the reason why it was being done – to secure their futures and careers going forward. But also very importantly it was crucial that they could see that their colleagues who were unfortunately losing their jobs were treated very well – with a very generous redundancy package – and very very fairly. It worked because it was all done within a strong framework of being consistent with our purpose".*

He is particularly proud of the St James Trust Charitable Foundation, one of the largest business charities in the country to which the company builds on staff charitable contributions to create a substantial force for good. It exemplifies that St. James Place Wealth Management is a different kind of company: one that can be trusted.

It is a virtuous circle: the more companies commit to purpose, clearly communicate that commitment and trust a middle layer of managers to run with it, making it live for the workforce, then the more the reciprocal belief they will win from employees – and the more they will capture the benefits.

One study reports that the more middle managers feel high purpose (giving high scores to statements like 'my work has special meaning: this is not just a job,' 'I feel good about the ways we contribute to the community,' and 'I'm proud to tell others I work here') and high clarity (with high scores on statements like 'management has a clear view of where the organisation is going and how to get there') then the firms had higher future accounting and stock market performance – roughly a 6 to 7 per cent premium in stock price per year.[19]

Supporting purpose by giving employees a stake – and accompanying reward – buttresses companies' commitment to purpose.

Peter Pritchard describes how moving from Private Equity ownership to becoming a PLC opened up an opportunity to cement purpose with offering employees shares:

> *"The different ownership models have been invisible at store level. But one huge positive of being a PLC is it has allowed us to put shares into the hands of every single colleague. My predecessor as CEO was insistent when we exchanged hands at PE that share ownership went a long way down the organisation. This was really smart. Our store managers got 18 times return which went down very well. Today every single colleague is a shareholder. They are much more engaged in the business because they own a bit of it".*

In fairness a cottage industry has been spawned to try and capture the benefits of employee commitment – DevOps, intrapreneurship, teams of teams with distributed control and centralised coordination, self-management, edge-centric decision-making and 'teal organisations'.[20]

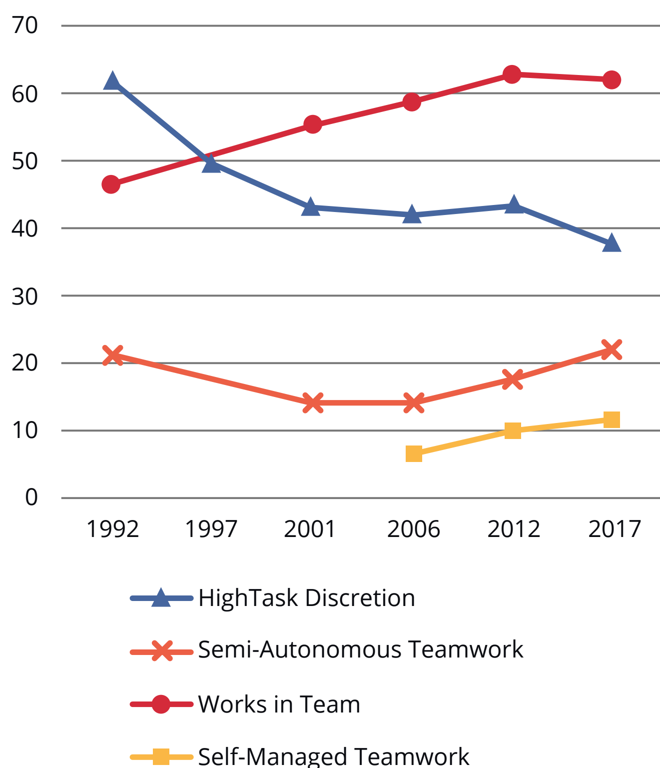
19 Gartenberg, Claudine, Andrea Prat and George Serafeim (2019) "Corporate Purpose and Financial Performance", *Organization Science*, 30(1), 1-18

20 Hamel, Gary and Michele Zanini (2020) *Humanocracy: Creating Organizations as Amazing as the People Inside Them*, Harvard Business School Press

But despite all this effort, little seems to have changed. Findings from the UK Skills and Employment Survey 2017 actually show declining trends in task discretion for all companies.[21] Specifically individual task discretion declined sharply between 1992 and 2001 and then stabilised between 2001 and 2012 before falling again between 2012 and 2017 – see figure below in blue.

This was repeated in all skill levels. Equally over the last decade there been a fall away in the use of formal consultative mechanisms. Brutally, for all the talk about purpose and employee engagement, it has yet to show on the ground. Micromanagement of employees is on the rise, consultation falling away.

Trends in Task Discretion and Teamwork (% of Employees)



It is a missed opportunity. For as **Professor Alex Edmans** and TPC steering group member describes vividly in 'Grow the Pie', purpose creates a sense of shared mission thus allowing a delegated autonomy which generates great places to work, performance and ultimately profit. More subtly, purpose opens up the opportunity of doing the right things – giving employees a stake in the business for example and enlarging their commitment – even if the payback is often not calculable:

> *"The core idea of growing the pie is when a company is driven by the purpose of creating value for society, this will ultimately translate into financial value, even if profits weren't the primary objective. It's important to acknowledge that even a company motivated purely by profit will still serve society. Even if a car company doesn't care about climate change, it will develop electric cars because there's money to be made. But their motivation is purely instrumental, and there are many decisions that can't be justified with a spreadsheet calculation. When AstraZeneca chooses to make its vaccine available at cost, it does so because it believes it's the right thing to do, not because it calculates that the PR benefits will make it NPV positive. Vodafone launched its M-PESA mobile money service to bring financial inclusion to Kenya, not to create a new revenue stream.*

21 Gallie, Duncan, Alan Felstead, Francis Green and Golo Henseke (2018) "Participation at Work in Britain", *First Findings from the Skills and Employment Survey 2017*

> *The power of the pie-growing mindset is that, even if a decision is motivated by the desire to create value for society, rather than profits, it may ultimately manifest in profits – people are willing to pay for products and services that create value. Vodafone ended up being able to monetise M-PESA. The pie is not GDP or financial wealth; it's social value of which financial wealth is one slice. If you grow the pie – create social value – it ultimately leads to financial returns".*[22]

Purpose is at the heart of growing the pie. But 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, which will need the support of the investment community. It is to their preoccupations we now turn.

22 Edmans, Alex (2020) *Grow the Pie: How Great Companies Deliver Both Purpose and Profit*, Cambridge University Press

Chapter 2: Asset Managers *and Purpose*

One of the principal obstacles to achieving purpose in Britain is the intense and near unique fragmentation of British shareholding structures which makes it harder to get sustained buy in for strategies with long-term payoffs. According to the OECD 2021 Corporate Governance Factbook only Finland and Iceland have more dispersed shareholding structures out of the 45 jurisdictions surveyed.[1]

Within this high rate of dispersion most British companies can still look to three shareholders to account for a fifth of their shareholders according to the OECD – but that is a weak platform from which to build a majority of shareholders aligned over purpose compared with other countries. **Anne Richards, CEO of Fidelity International** had this to say on the issue in The Purpose Tapes:

> *"I do think that companies that are serious about sustainability and purpose need to think really hard about what they want their shareholder structure to look like. There are many large investors like ourselves, who are trying to put sustainability and purpose much higher up the evaluation ranking. But we're not every investor. There are unquestionably investors out there who are focused on a much more short-term view on financial returns. And so it's important – as corporates have always historically done – to think about getting in the right shareholders who will be supportive to a corporate's purpose, particularly if you are a corporate that is really trying to pivot. For example, if you're a heavy fossil fuel-producing or fuel-using corporate, and you're trying to pivot requiring some quite sizeable investment, you want to try and attract supportive shareholders who will give you a longer period of time in which to earn a return – rather than having a book of investors who will turn off the taps on you to maximize profit in the short term. But longer-term horizons should not allow latitude on sloppy financial metrics".*

Peter Pritchard ran Pets at Home both under Private Equity ownership and a publicly quoted company. A fragmented shareholder base works against clarity of purpose, agility and speed:

> *"I think the difference between Private Equity (PE) and a PLC in some respects is the level of sharpness that you experience in PE. In PE you've got a shareholder who's sat at the table and in the PLC world you've got a shareholder who is always one stage removed from the table. We often talk about shareholders: now we've got 258 of them. In PE we had one and they were there in front of you. You knew their opinion because they showed up with it. That created speed and a very clear understanding of their expectations. I've got loads of shareholders who have all got expectations but different – some on more growth, some on dividends, some*

1 OECD (2021) "OECD 2021 Corporate Governance Factbook"

> *on a cash buyback. So you end up in a slightly more blurred world with investment managing an average. With PE there's no misunderstanding about what's important to them. On top, the timescales are much more evident because there's a start and there's an end and that creates pace".*

In our own work at The Purposeful Company we have identified the importance of a critical mass of independent blockholders as crucial to companies' capacity to secure majority shareholder support for purpose – while retaining a degree of distance necessary for dispassionate scrutiny, in some respects reproducing Peter Pritchard's experience of Private Equity – and how British shareholding structures make that tougher. The reality is that investors with large ownership stakes necessarily have the incentive to look beyond short-term noise and invest time to gain insight into the detail of what creates value and costs at the companies in which they are invested: they can expect to benefit disproportionately from any improvement in performance.[2]

Companies with a critical mass of blockholders tend to adhere more to purpose

Other researchers find that institutional investors with large stakes are associated with higher R&D and innovation.[3]

The open question is how to achieve similar effects in a landscape without blockholders and where there are proper regulatory prohibitions against collusive shareholder behaviours. Over and above that, an additional problem is that actively managed investment funds, which as the 2021 Investment Association Annual Report observes, still constitute the majority of UK funds under management, are competing to deliver better performance than the others: one of the deterrents in firmly aligning themselves with other asset management house strategies in supporting a purposeful company to simulate a blockholder effect is that it implies, as Saker Nusseibeh, CEO of Federated Hermes acknowledges "my competitive advantage is eroding". Collaborating fund managers are less free to buy or sell at advantageous prices because they are now part of a coordinated engagement team. On the other hand, there are clear advantages to collaborating if it will lead to outperformance of the company over time. One study of 31 joint engagements organised by the Principles for Responsible Investment over an eight year period showed that success was most likely with one strong domestically based lead investor taking the lead with an average of 21 unique investment companies in the collaboration. Such third party leadership seems to be the most effective.[4]

The difficulty, as Dame Carolyn McCall observed, is that investors do not want to be made insiders. The investors we spoke to were all open to the benefits of co-ordination and collaboration while guarding against that risk. One avenue is to have a predeclared position so that other investors – and companies – know your likely stance on any issue, and how you will react.

2 Edmans, Alex and Clifford Holderness (2017) "Blockholders: A Survey of Theory and Evidence" in *The Handbook of the Economics of Corporate Governance*, Volume 1, 541-636

3 Aghion, Philippe, John Van Reenen and Luigi Zingales (2013) "Innovation and Institutional Ownership", *American Economic Review* 103(1), 277-304

4 Dimson et al, Coordinated Engagements, European Corporate Governance Institute – Finance Working Paper No. 721/2021

Jack Daniels of M&G Investments:

> *"There are rules and regulations in place for good reasons around the disclosure of non-public information and about people acting in concert or in collusive ways which are not positive. So it's important for large investors like M&G to have clear positions on various things, so that when certain situations do arise our behaviour will be predictable. There isn't a perfectly formed, consistent approach across the industry".*

It is an approach shared by Generation Investment, **David Blood**:

> *"We will engage with other investors: we'll be very clear about our engagement priorities and be transparent about it. But we don't coordinate specific company views, we coordinate policy if you will. So for example we were among the founders of The Net Zero Asset Managers initiative – now part of the Glasgow Financial Alliance for Net Zero that Mark Carney, Michael Bloomberg and Mary Schapiro have led over the course of the last year or two. There, we are collaborating very directly with a group of managers so yes we work with others, but we're careful that our collaboration is industry-wide as opposed to company specific. Though I'm sure that most of our fellow asset managers know where we stand on issues".*

Making sure that fellow asset managers know where you stand – and the companies in which you invest – is an important tool. One group of researchers who studied the release of so-called expectation documents on firm behaviour showed that firms do respond – for example changing their corporate governance arrangements, with smaller firms whose shares are less liquid moving more quickly.[5] Moreover, the effect is spread across the market, obviously with a bigger effect the larger the investor. Equally asset managers tend to adjust their own portfolios so that their investments correspond to the dictates of the expectation document.

Saker Nusseibeh, CEO of Federated Hermes, endorses the value of working with other asset owners and managers – in particular to lower carbon emissions:

> *"We do a lot on engagement, now going back for a long time, increasingly more with asset owners because you have more impact (for example Federated Hermes act for Faith Ward's Brunel Pension Partnership). We are part of the C100+ initiative, for example, where investors engage with well over 100 of the largest carbon emitting companies in the world to reduce carbon emissions: we lead on more than 30% of these engagements. It's both important in its own right and also an opportunity for learning – it's not as if we are sole custodians of the gospel truth. We have an approach, and we respect and learn from other people's approaches".*

5 Aguilera, Ruth, Vicente Cuñat Bermejo, Javier Capapé and Vicente (2020) "The Systemic Governance Influence of Universal Owners: Evidence from an Expectation Document", *ECGI Finance Working Paper No.* 625/2019

However, he stresses the value of direct engagement – vital to get under the skin of a company and understand the nuances:

> *"Investment is nuanced and decisions have to be contingent on realities. So yes, in general, having a chair/chief executive is not best practice corporate governance but there are times when it can be the right thing. Again, in general, yes, having companies with two share types, A and B shares, is not optimal. But in some very few cases it can be the best way to secure purpose or start-up growth, for example. Which is more important, purpose or shareholder primacy? Well, it depends on the detail of what the voting rights are. It's a much more complex and nuanced way of looking at the world. The only way to resolve these issues is engagement – why our engagements have been successful over such a long time is because engagement is subtle and with the goal of investors' interests always in mind".*

Fidelity International is a purposeful company in its own right – its purpose is 'helping people to build better financial futures'. **Romain Boscher** says that one means to simulate the advantages of blockholding for funds like theirs is to invest alongside a founding family who retains control, thus bulking up the proportion of shares committed to the founders' purpose. This helps overcome the perils of too much fragmentation, and is a powerful means to deliver purpose:

"If a business is clearly controlled by the founding family, it tends to do better from a purpose perspective because its purpose is part of the family DNA – and that spills into the company over generations. So even when one generation succeeds its predecessor in leading the family ownership, it is usually an opportunity not to lose the purpose – but to renew it through the choice of CEO. That is very much the story at L'Oréal, for example, and in my view one of the drivers of its sustained success. For us family control is often a signifier of purpose and long-term value generation that we want to support".

Whether they actively co-ordinate with others, predeclare their positions, contract third parties or invest alongside founding families, all the asset managers we interviewed shared Saker Nusseibeh's endorsement of the benefits of active engagement. It is firmly echoed by **Romain Boscher** at Fidelity, who emphasises the advantages of scale:

> *"Our strength is that we are big enough to be impactful and thus worthwhile to engage with – both by the companies in which we invest or with other investment houses where there are common concerns. It's easier to be heard. And it's even easier because we have not only the size to punch our weight but fifteen thousand meetings a year worldwide. Yes, a small number are arranged by brokers or by banks, but the vast majority are one to one meetings with*

the C-suite. We reorganised and rationalised our corporate access function a couple of years ago so that we can pre-define and focus the agenda, to be the one in the driving seat so to speak, rather than just come along for a general conversation".

David Blood's Generation Investment is similarly committed to engagement, but as he says to do it effectively takes a "huge amount of time and effort". It does not come cheap, and his solution is a very high focus on comparatively few firms:

"We intend to invest in businesses and own them for a long period of time. Now we won't always do so, because businesses have their ebbs and flows and challenges, but our orientation is long term.

Bluntly, research takes a huge amount of time and effort. We made the decision to invest in a small number of companies. In our global equity public portfolio today are about 45 companies: we cover about 140 companies around the world that we could put into our portfolio. So there's 140 that we work with as if we own them, but there's only about 45 in our global equity portfolio.

And since we have 20 plus people in our global equity team, each one of our analysts are covering 8-10 companies, and they've been covering these companies for, in some cases, a decade or more. We know these companies well. We do much more due diligence than the public filings. We talk to suppliers, we talk to the management team, we talk to the board and we talk to competitors. We're constantly assessing the quality of business and quality of management. We don't have a check-list, but we analyse the drivers of each business. In terms of how companies manage purpose, we're looking at what are the drivers of each of the businesses and who are the stakeholders, and how do we assess how they're doing. Companies will be quite good in some things. Some companies will be terrible, in which case we won't invest in them. If a company is doing excellent work in four or five areas but needs to improve in others, we will engage with them and will say, 'look, your remuneration policies are incentivising what we think is inappropriate capital allocation, or inappropriate commitment to the long term,' for example. And we will work with them to try to change the way they think.

Like everyone, we make mistakes, and as we assess businesses we're learning all the time.

And sometimes we get happier with our decisions, and then there are some times where we recognise that what we thought might be true about a business model ultimately has structural flaws to it, or even core flaws to it. And then we will divest in those instances. Or if the management team simply is not rising to the standards that we expect even though we've engaged with them, we will divest in those instances.

Periodically, we will be public in talking to management teams about what we believe they should do. But mostly we're quiet folks in the background if you will".

Passive funds track the index across the market, which constituted 34% of assets under management in 2021 according to the Investment Association. The conventional wisdom is that the more diversification, necessarily the less engagement because the investor cannot increase or decrease their weighting of shares above the index weight. Because the number of companies with whom index funds have to engage is the whole population of firms in the index, engagement on this scale – is expensive. But despite this, there are good reasons to think that diversified funds, in the right conditions, do have strong incentives to engage.[6] It is because they cannot divest they are obliged to be engagers. **Sir Nigel Wilson** confirms the research, and how large funds can afford the expense:

"To call our funds passive is a misnomer. We are one of the world's top ten fund managers worldwide with £1.4 trillion of funds, so any holding is likely to be significant. For example, we own about £40 billion in the FTSE 100. On average we get paid about seven or eight basis points which works out at £28 million of revenue. Let's say it's a 50% margin, so that's £14 millions of profit – more than enough to pay for engagement.

People may call these funds passive, but they are very active in one sense because you're committed to investing in this business because it's a member of the index. Therefore, you have to engage with it. We've always believed in active engagement; we're good at it, we get things done and people like to partner with us. We are not high frequency traders for long/shorts, over ultra-short time periods using computerised algorithms and Artificial Intelligence – now a very crowded market. That's not the business we're in. We're absolutely built around long-term macro-economic and demographic trends.

The purpose of our meetings with companies is thus not to buy or sell – it is to find out how far are they down the road of becoming a purposeful company. What do we think is right or wrong about their behaviours – all male boards for example? We're not out to benefit from having any insider information because we don't actually do active equities".

Engagement by passive funds is a general trend – although it should not be oversold. So for example one researcher confirms that while index funds do have a positive causal impact on governance, their interventions are typically low cost where they can apply general principles (e.g. voting against dual class shares) without having to practise more bespoke or intensive forms of engagement.[7]

6 Fisch, Judith, Asaf Hamdani and Steven Davidoff Solomon (2020) "The new titans of Wall Street: A theoretical framework for passive investors", *University of Pennsylvania Law Review*, Vol. 168, 17; Gordon, Jeffrey (2022) "Systematic Stewardship", *European Corporate Governance Institute Working Paper No.* 566/2021.

7 Appel, Ian, Todd Gormley and Donald Keim (2019) "Standing on the Shoulders of Giants: The Effect of Passive Investors on Activism", *The Review of Financial Studies*, 32(7), 2720-2774

They cannot commit the effort of, say, Generation Investment. The consensus is that while index funds do some monitoring, it is less than the active funds they are replacing.[8] In addition monitoring and engagement tend to be unequally distributed across firms, concentrated in large firms who can afford to do it like Legal & General.[9] However, one study finds that while the top three index fund families do engage, they have on average only 21 investment stewardship personnel to cover 17,849 firms in their portfolio.[10] That is 850 companies covered by one analyst compared to the 8 to 10 per analyst cited by David Blood. In the end the incentive structure triumphs: it may be true that engagement pays off, but with lower management fees necessarily the passive investors benefit less from the rise in the share price – so the incentive to engage, although it exists, is less powerful.[11] **Jack Daniels** offers a practical assessment:

> *"From the perspective of a traditional index fund investment, if the funds you run have sufficient scale, and you are serious about engagement, then you ought to be able to find a way to invest responsibly, regardless of low fees. But if a company is part of the index and it doesn't respond to engagement, then divestment is not possible. Passive investors are locked into companies which are part of an index".*

Successful engagement is subtle: asset managers need to make well informed judgements that management teams are willing to hear and take on board. Generally, the consensus among our interviewees is that it is best done privately, only escalating to public criticism or challenging managements with shareholder resolutions when other avenues have failed. **Professor Alex Edmans** differentiates between successful engagements where there are win/wins for investors, the company and society at large – but other engagements where substantial costs may have to be borne by the company but for which those instigating the change do not take responsibility or acknowledge, rather enjoying the halo effect of good public PR. Echoing David Flood he thinks the best engagement is private:

> *"I fear that some engagements are undertaken to get good PR. Sometimes asset managers might be engaging on issues where they are relatively uninformed, so it becomes like micromanagement, such as how much to pay workers. Management often has much greater knowledge of labour market conditions than outside investors.*
>
> *Some of the best forms of engagement are private conversations between investors and management. Why? Because when things become public then egos come into play. After a public statement by an investor, then the management will disagree. And even if they subsequently talk and the management thinks perhaps the investor was right, they're unlikely to do a U-turn and accept the investor's proposition, because that will be publicly humiliating. With a private discussion there are ways of altering*

8 Heath, Davidson, Daniele Macciocchi, Roni Michaely and Matthew Ringgenberg "Do Index Funds Monitor?", *The Review of Financial Studies*, 35(1) 91-13.

9 Iliev, Peter, Jonathan Kalodimos and Michelle Lowry (2020) "Investors' Attention to Corporate Governance", *Review of Financial Studies*, forthcoming

10 Bebchuk, Lucian and Scott Hirst (2019) "Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy", *Columbia Law Review* 119, 2029- 2146

11 Lewellen, Jonathan and Katharina Lewellen (2022) "Institutional Investors and Corporate Governance: The Incentive to Be Engaged", *Journal of Finance*, 77(1), 213-264

course without public embarrassment. I feel too much engagement has been public – because investors want to take the credit for this. It is wanting to get the credit for engagement, rather than actually to create value".

Then follows the issue of what to do when engagement has failed. All our interviewees took the view that while divestment was not desirable, it was always an option. **Mark Versey, CEO of Aviva Investments**, the subsidiary of Aviva managing £232 billion of assets, outlines the company's increasingly tough line on net zero commitments while still steering clear of complete divestment:

"When you make investment decisions, you need to look forwards to take a view on how a company will evolve. So while you can buy some ESG data, for example carbon emissions of large corporates, the data is just a useful reference point looking backwards, and that's not enough. So we have a huge number of ESG professionals, and they are deeply embedded across all our investment teams.

We have additional different processes, depending on which sector we are investing in, where we push for future change. Two years ago, we created a climate engagement escalation policy and wrote to the top 30 carbon emitters globally because they're so systemically important to the world – the big oil/gas extractors and utility companies. We gave them a list of criteria we needed them to action including signing up to net zero with science-based targets and a timeframe to do so or we will divest from owning them. We gave them three years to sign up, because if they are going to get to near zero at any decent timeframe, they need to move quickly.

We will repeat this escalation approach across different sectors over time. We won't end up divesting from all oil and gas, just because they're high carbon. We will end up owning the ones that are going to migrate and become greener, in a very sustainable and financially economically sensible way as well – good for customer returns and good for the planet".

Jack Daniels at M&G Investments takes a similar tack:

"We undertake constructive engagement with management of companies, with the aim of encouraging better ESG practices; but we recognise that divestment may be necessary in certain situations. Where we can see situations where management are focused, where improvements are being planned, where there is a clear objective which we believe meets our criteria around sustainability – then we prefer to engage. Equally if we don't see any of that, we are

prepared to divest. The problem with divestment is that you're selling your position to somebody else, and you haven't done anybody any good".

Research confirms his view. An important academic paper finds that divestment rarely achieves its intended goals.[12] To have impact divestment must change the cost of capital of the affected firms, but generally the effect is so small that firms do not adjust their decisions. Barclays Bank concurs, commenting that it is only when a critical mass of investors pushes in the same direction – and when companies are constrained by a need for capital – that market pressures tend to be felt. The better route is to engage to secure change.

In sum, responsible asset managers we spoke to in a highly fragmented and competitive industry do what they can to promote purpose given their resources, size and influence – but engagement tends to remain the provenance of individual asset managers, co-investment a preferred strategy and divestment a last resort. The Investor Forum was established to promote greater capacity for asset managers and owners to co-ordinate their engagements, but inevitably it engages with particular flashpoint issues rather than as a general platform for sustained company support. Nor do the managers we interviewed, although large, represent the entirety of the market – they tend to be leaders rather than explorers or observers in one typology, who still constitute most of the market.

While there is some progress to build on, Britain has much further to go if it is to get nearer reproducing the effects of having independent blockholders and all that flows from them.

Getting beyond the ESG acronym to invest in what it stands for rather than the label

Assets in ESG funds grew 53% in 2021 to $2.7 trillion to become the fastest growing part of the global investment market – but as observed in the preceding chapter what constitutes an ESG fund has become increasingly challenged. It is not only that rating agencies differ, sometimes wildly, in their assessments of which company qualifies as meeting which particular ESG criteria with even the same criteria being scored very differently, but investment managers themselves interpret the ESG mandate differently. Some for example screen out sectors such as fossil fuel or defence companies completely while others engage in order to change them – while assessments of what constitutes good governance can vary hugely.

The concerns were crystallised on May 31st 2022 when German police raided the offices of one the world's largest asset managers DWS, a subsidiary of Deutsche bank, on the grounds that many of its ESG funds were falsely labelled and investors were being defrauded. A day later CEO Asoka Wohrmann stood down.

At the same time the war in Ukraine meant the sectors like defence and fossil fuels, which ESG investors had either avoided or chosen to be underweight, had a sudden re-evaluation. Interestingly it has been European funds, according to the 2020 Global Sustainable Investment Review, that have been more likely to screen out difficult categories of ESG investment than their US counterparts – and are now asking harder questions about their stance. After all western economies needed strong defence industries in a world made more hazardous by Putin's aggression, while energy resilience required maintained flows of fossil fuels before nuclear and renewables took up the strain. Given these societal needs, was it wrong to argue that defence or fossil fuel companies could not count as candidates for ESG investment?

12 Berk, Jonathan and Jules van Binsbergen (2021) "The Impact of Impact Investing", *Stanford University Graduate School of Business Research Paper*

Suddenly the debates about what constitutes ESG investing have acquired a new urgency. **Ian Simm, founder and chief executive of Impax Asset Management** is quoted in the Financial Times of June 6th 2022 as saying:

> *"I think we should dial down or even stop using the phrase ESG. We should push people very hard to be clear about what they want when they use it. And in an ideal world ESG would disappear as an acronym. We would find a better way of labelling the conversation".*

Our interviewees agreed that the acronym had become unhelpful and indeed that the conversation needed changing – but stood by the values of sustainability, ethics, social responsibility and good governance that it aimed to promote. In this sense ESG is so integral to successful long-term investment that every investment should be consistent with best ESG practice. **Saker Nusseibeh**:

> *"Every single fund we run here integrates ESG. We don't call them ESG funds. I don't understand how you can invest if you don't incorporate material ESG performance into the core of your investment strategy. ESG investing, purposeful investing if you like, responsible investing is not simply you ticking a box and that's you done. It's a much more nuanced affair: it takes time, consideration as part of a company's sustainable business model and the results unfold over time. That's why I think that you would be irrational if you did not look at purpose, at social impact, and ESG in general in whatever investment you're doing, because otherwise in effect you're actually trading not investing. Mathematically a trade produces less performance than not trading".*

Jack Daniels concurs:

> *"At M&G Investments, we include ESG and ethical considerations within our investment process, whether in public or private markets. For every investment opportunity, we aim to have a well-developed view on the ESG factors that drive valuation and the impact on the business and for our investors".*

Sir Nigel Wilson sees the approach as a building block for everything Legal & General does to deliver economic and socially useful outcomes, but is not especially keen on the acronym, indeed wanting to include H for health in the title – and never having an internal meeting that is called ESG:

> *"There's a lot of pledging going on over ESG but not a lot of doing. So what are examples of things that we're doing?*
>
> *We see ESG as a building block for part of what we're doing to deliver economic and socially useful outcomes. But we would never have a meeting that's called ESG. Rather we discuss climate change, clean energy or biodiversity.*

Actually we prefer to call it ESHG because of the importance of H for health.

It was Covid that really drove home to everyone the necessity of being concerned about health. We have an amazing amount of data as the biggest life insurer in Britain, and see all sorts of different trends happening – we partner with UCL's Michael Marmot better to understand them. We want to make sure that both our staff's physical health and mental health is good: it is the right thing to do – it makes us a better firm if we do that. We have as many mental health first aiders as physical health first aiders because we know they're about equal in terms of the problems that staff have. Building better housing, another part of what we do, is all part of providing a better healthier outcome for people".

Andrew Croft shares in the realism: it is the issues that count, not the acronym:

"I don't think clients know what the acronym ESG stands for. But if you talk to them about specific aspects of ESG, then they become far more engaged. So climate is really important: so is inclusion and diversity. It's the particular issues that matter – not the acronym".

Mark Versey, argues the green agenda is not only right – investing in it makes complete commercial sense:

"Our purpose is to deliver exceptional client experience while building a sustainable world. We're a sustainability champion. Our investment philosophy of 'Buy brown, make it green', adds value for customers and adds value to the world, a dual purpose.

Take a commercial real estate office, if you can take a brown building – brown meaning high carbon emissions – and refurbish the building, you can make it a green building. You reduce the energy usage using latest technology, you then change the water and heating to be based on renewable electricity, and then you might add solar panels on the roof, have more energy efficient windows, etc. You can effectively make your building net zero and make the world a more sustainable world. But that green building is in higher rental demand than the brown buildings around it, because corporates are racing to get to net zero. You can increase the value of the building substantially by converting it to be a green one. So that's delivering financial return while building a sustainable world.

Fundamentally, it's the right thing to do – sustainability is what we believe in but it makes very good business sense at the same time. Take Aviva. If we end up in a world with a four degree warming, then you're going to get huge swathes of assets that won't be insurable. If you're an insurer, a world of four degree global warming could be

a massive threat to the entire business model of an insurance company. We shouldn't let that happen. Investing in companies that are adapting to being more sustainable is the right way to get a better financial return. Taking action makes really good business sense. It is in the best interests of our existing customers, it is important for attracting new customers to grow our business and ethically, it's the right thing to do as well. So you've got all stars aligning".

In **Chapter One** we described how companies, given the lack of a common framework in which to locate, rank and evaluate ESG measures, have had to take matters into their own hands, creating their own narrative and reports. Investors are doing the same. Fidelity decided that ESG is of sufficient importance, and the rating agency metrics so variable, that it should do the evaluations itself. **Romain Boscher**:

"We have material differences with credit-rating agencies, not only regarding what we consider is the best practice methodology, but what we think the follow-through in practical consequences should be – which also needs evaluating. Sometimes we are perfectly aligned, sometimes not. Why? For two reasons. First, we have decided to invest a lot in ESG, so we have an obvious interest in delivering the best methodology, incorporating a review of any rating at least once a year. It isn't junior people at the end of the room doing ESG stuff: it is a central part of our financial approach, so we want them to grow in terms of ESG awareness and their ability to assess ESG criteria.

And secondly on top of the huge investment we are making to do the job properly, we've chosen to say: 'We are remaining forward looking and judgmental, much more than backward looking and purely data driven'. It is a signalling mechanism. Any company adopting an ESG approach knows it will not be enough just to optimise or maximise a couple of data points as it might to satisfy a rating agency. They know they will be engaging with a major investor who has made a major commitment to appraise ESG – and that makes a difference".

M&G Investments takes a similar view. **Jack Daniels**:

"Can we do a better job than the credit rating agencies? We think we can, but if you're an investor, is that difference so meaningful and so much that it's going to make a difference as to whether you invest with us or not? When it comes to purpose and impact investing, we can add value through engagement but, for want of a better description, just a simple measure of our ESG score is unlikely to enable us or any of our competitors to differentiate themselves that

much. We believe that consideration of ESG factors is a much more complex and nuanced process than simply publishing a score".

David Blood is critical about the term ESG – but shares the view that the way forward is to pose the question differently: the challenge is to run a sustainable, stable long-term business:

"ESG ratings are extremely challenged, because they are often opaque, and they often are weighted to whatever the methodology supports. So it's not at all a surprise to us that a sustainable company can be kicked out of a ranking and Exxon put into it, because it depends on the methodology. We think ESG as an outcome – rather than an input into a sustainable investing process – is widely misused and misunderstood. We want people to think about how to run sustainable, stable, long-term businesses. But to say that an ESG rating reflects the value or the contribution of a company to society is at best a blunt instrument, and possibly misleading".

What is striking is that one way or another all the investment managers we spoke to are working to keep ESG alive and meaningful by integrating it into a systemic approach to investment while avoiding being trapped into narrow tramlines. Like St. James Place Wealth Management, 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. Machine learning is being used by investors to analyse unstructured textual data such as high frequency company level news flow or job postings data that are often a leading indicator of future changes in a firm's purpose or ESG ratings.[13] Tools such as the Return on Sustainability Investment (ROSI) framework and Impact-Weighted Accounting (IWA) are attempting to monetise dependencies and impacts in relation to both cost and fair value accounting in ambitious ways. 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.[14] **Sacha Sadan of the FCA** observes that given the growth of ESG investing and the permanence of the attitudes it represents, the industry and regulator alike will just have to get better at measurement and evaluation:

"The fastest growing asset allocation has been into ESG products – that is commercialism and therefore the market has moved to that. This is not just fluffy, woke stuff; this is money being moved into pension schemes that have better ESG credentials than non-ESG savings products. This might slow down but it isn't going to change. That then forces the investors and companies alike to have specific answers.

13 Ben Dor, Arik, Jingling Guan, Xiaming Zeng, Adam Kelleher, Adam Lauretig and Ryan Preclaw (2021) "Identifying Planned Corporate ESG Efforts and Predicting ESG Rating Changes Using Job Postings Data", *Barclays Systematic ESG Research*

14 Cohen, Ronald (2020) *Impact: Reshaping Capitalism to Drive Real Change*, Penguin Press; NYU Stern Center for Sustainable Business https://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/center-sustainable-business/research/return-sustainability-investment-rosi; Impact Weighted Accounts Project, https://www.hbs.edu/impact-weighted-accounts/Pages/default.aspx

My job is to help package financial products with the right labels. We will come out with labels that are fit for purpose, so that an average consumer could look at that product and ask 'Is it green or is it diverse? Is their thought about social issues? And if so could the managers explain what they are trying to achieve?' If they can't, it cannot have the label. So our plan going forward is to make ESG much more descriptive and less fluffy with metrics that the underlying investor can be proud of".

In fact since he was interviewed the FCA has brought forward proposed restrictions on how the product labels ESG, green and sustainable can be used for marketing, a more general anti-greenwashing rule and more disclosure. It is a significant step.

Yet it remains important to distinguish between purpose and ESG. For her part asset owner Faith Ward distinguishes between the difficulties plaguing ESG and the less contested standing of intrinsic purpose as driving value creation: Investors should hold in mind purpose and position ESG as a dashboard cum checklist of things needed to be worked through to achieve purpose and there is a resolution of the debate:

"I'm not very fond of the phrase cum acronym ESG – it's a collective umbrella term trying to capture disparate and different risks at varying levels of business threat. I often say that the acronym should be almost BSEGP – it's business strategy, the environmental risk, the governance risks, the political risks. The acronym ESG doesn't really do justice to the actual threats about which I must be aware and genuinely concerned.

Purpose, on the other hand, frames what you're trying to achieve, and so how to think about these risks in a very structured way to help you to achieve that purpose. Purpose is what you're trying to do: ESG is the how. So purpose is much broader. It encompasses ESG which offers a sort of dashboard of things you need to have worked through. Is it material? Are these things that will impact our business? Are they positive or negative? They're sort of a checklist in order to help the business achieve the purpose it has set itself".

Mark Versey, shares the distinction between purpose and ESG – but emphasises that in practical terms purpose is taking on an ESG dimension:

"Purpose is what the company exists to do – typically it is the role that the company plays in serving customers in society. But in my view purpose increasingly is going to have to expand to meet the need of multiple stakeholders – investors/shareholders, governments and wider society – because it's not okay to manufacture goods while destroying rainforests, polluting rivers or the air or enabling human rights abuses to happen in your supply chain. All those things will

increasingly damage the long-term viability of a corporate and make it an unattractive investment. So, purpose, I think, will increasingly flex to have a sustainability angle to it – as it has at Aviva.

'ESG' is a series of factors or considerations – these are lenses through which we look to assess the sustainability of an investment. It might be on board composition, or supply chain resilience, or whether their climate change commitments stack up. The ESG credentials of a company represent a judgment of these factors that we use to help consider whether to make an investment or not, but they are not the whole story. Investment decisions remain clearly driven by the financial analysis of the company such as its balance sheet strength, product quality and competitive differentiators. ESG is not an investment philosophy. It's just a way of assessing wider risks of a corporate".

It is a common sense view that represents the emergent consensus amongst both the investors and companies we interviewed. There was general agreement that the focus on climate, health, governance and societal impacts by both investors and companies was not going to go away – but given the current problems with finding common metrics, trying to shoehorn everything into one catch-all category called ESG was potentially unhelpful although on the plus side it had played an important role in galvinising both investor and company engagement with the issues. Companies would do best to integrate their policies in these areas into mechanisms for achieving their purpose demonstrating that so doing materially decreased business risk and enhanced value. Investors for their part were best to engage with the companies in which they invested judging them by how effectively they did that. ESG factors would thus became practically integrated into a systemic approach to company and investment strategies alike, pending regulators and international accounting bodies coming up with an internationally agreed reporting framework.

That leaves multiple challenges in the meantime. Not all shareholders care about purpose or invest mindful of its commercial usefulness, and have perforce been compelled to take ESG factors more seriously only because their clients demand it – without necessarily having the tools to meet their promise. Should they, for example, engage or disinvest from companies in difficult areas like fossil fuels and defence? How could they avoid charges of greenwashing? How can they demonstrate, given the increasingly charged debate in the US, that what they are doing promotes long run financial returns?

The important news is that investors, companies and regulators know they have to develop practical answers and are doing so. Investors agree in the main they should engage and co-invest with companies in whatever sector as they transition to better business models and if they are considering disinvestment to signal well in advance why that might happen – and what could be done to avoid it. Investors should call for and companies respond to the demands for disclosure of information considered material to the strength of the business model in the future. Here a commitment to purpose by both investors and companies helps resolve tensions. The more companies set themselves a purpose from which they can demonstrate long-term value is created, the easier it becomes to show how everything else – ESG included – falls into the wider picture.

Chapter 3: Asset Owners *and Purpose*

All professional investment is rooted in original savers to whom investment managers are ultimately responsible. However there are savings institutions – pension funds, insurance companies, family offices – who are first and foremost institutional asset owners, aggregating individual savings assets, rather than managers. They may manage their assets directly themselves or contract out all or part to professional investment management companies, but they have greater clout as savings conduits because of their scale in expressing their investment priorities. Plainly how they set out these priorities in their mandates is of immense importance; the impact of how they interpret and understand their beneficiaries' evolving preferences radiates around the capital markets. **Jack Daniels of M&G Investments**, part asset owner and part asset manager, spells out how faithfully asset owners want to express their clients' preferences:

> *"Clearly our clients want us to generate good financial returns, but increasingly, they also want their savings to be used for investments in businesses that are trying to make the world better, not worse. So, if more of our customers care about purpose, then our job is to express that purpose by adopting a responsible approach to investing. This way we can deliver not only financial benefits but also positive social and environmental value over the long term through the way we actively invest".*

The Brunel Pension Partnership is a pool of 8 local authority pension funds whose funds available for management total £35 billion. **Faith Ward** is the chief responsibility officer, whose job is to ensure the funds are managed in line with the wishes of the pensioners – present and future – for whose aggregate pensions they are responsible. She describes the dilemmas and tensions of a hands-off relationship with those who manage the assets on their behalf – and the strength of the Partnership's commitment to purpose:

> *"It is more hands off. We do struggle with this because we don't choose the individual assets leaving the effective management of those to the fund manager. However, we do require to see that the companies in which we invest are purposeful. If we are satisfied that requirement is being followed then it is likely that any reputational risk of owning that company is less, and the performance stronger. Purpose will make it more resilient to whatever shocks there might be, whether financial or societal over the long run – and that feeds through to the bottom line.*
>
> *The open question is how much discretion we should give our fund managers to engage with companies to move them on to this trajectory – particularly if they think the companies' shares are undervalued. Of course, some managers are good at spotting these situations successfully. But even then, we have to consider the time scale.*
>
> *How long is any improvement going to take? How much of a journey is it? And is it feasible? The key is communication and keeping*

in close touch with the fund manager. But it's not easy".

The Partnership set out in their Responsible Investment Policy Statement seven priorities that their savers identify along with expectations and targets that Brunel, as custodian of their savings expects to be met: 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. Some of these preferences are negative, such as ensuring investee companies pay taxes, avoid modern day slavery, and do not employ child labour etc. Others are positive, requiring a broad swathe of ESG objectives to be pursued and reported on. This can mean accepting lower financial returns – but **Faith Ward** says there is a keen recognition of the tradeoffs along with a careful assessment of the risk-weighted returns of what being a principled investor implies:

"We are a 'universal owner' in the sense we are invested in every asset class and virtually every company – we have £35 billions of assets for which we are responsible which our varying specialist managers manage on our behalf. If you're owning so much across all these markets, and the local governments whose pensions funds we act for are essentially behind you, then it makes sense for us to accept and balance the trade-offs in sometimes costly investment and a weaker relative share price performance that can follow. If we don't then you will end up paying for it somewhere across the broader scheme of things.

This brings challenges that we have tried to convey through our stewardship and our responsible investment reports, explaining either we need to pay more or have lower returns for the capital investment needed to put a particular company on a more sustainable footing over the long term. It's accepting the obligations of universal ownership. And we are committed to and accept all the implications".

In all these areas there is an expectation of high quality levels of reporting on what companies consider material to long run business sustainability – the same expectation as asset managers. Asset owners also extend their concerns to companies whose debt they hold. In response the asset management companies competing for mandates are designing investment funds with specific targets for investment – health, biodiversity, net zero etc. Some allow funds within the same group to vote in the context of their specific investment mandate, which may mean that within the same management house varying funds are voting differently. **Jack Daniels**:

"As active managers, we consider active and informed voting part of our responsibility to investors. While we share a common set of principles, we do not manage by consensus. We might have situations where different funds vote differently on some issues; reflecting different investment views or specific client preferences. But we ensure we do vote and by exercising this right, we seek both to add value and protect our interests as shareholders".

There is evidence of tension between asset owners and asset managers over voting, with an increasing number of asset owners wishing to be involved more closely in voting decisions, retaining voting rights or delegating voting only within clear and transparent guiderails; and 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 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. Votes on special resolutions on controversial issues can become particular flashpoints. **Faith Ward**:

> *"I'm strongly in favour of pass-through voting rights. One of the main arguments for not doing it as an asset owner is you're taking away from the manager part of their toolkit in terms of engagement about change. The way we manage that is we send all the votes that we're going to make to the manager that owns the stock and ask 'Are you comfortable with the way we intend to vote: do you materially disagree with it? Tell me if you think I'm wrong'.*
>
> *So rather than completely disenfranchise the asset managers, we work in collaboration with them. We ask them just to escalate things they think are material rather than divvy up the votes fifty-fifty. Equally they can contact us proactively to say that they want to vote in a certain way".*

However, some asset management houses are actively encouraging pass-through voting. For example, BlackRock has announced that it would start allowing some of its institutional clients to cast their own votes rather than having its investment stewardship team vote proxies on their behalf. Other asset owners try to avoid frictions by pre-declaring when they award a mandate that either they will be retaining voting rights in some areas – or establish a system of close interactive consultation. **Andrew Croft** spells out St. James Place Wealth Management's approach:

> *"Our unit trusts are managed by a third-party manager. We require our funds, for example, to be managed in line with the UN principles of responsible investing. So for instance if there's a company out there investing massively in thermal coal because they see a great opportunity, the chances are we can't invest in that anyway. So that's that. We retain the right to vote but in the main we allow our fund managers to vote on our behalf.*
>
> *We monitor whether and how our investment managers are voting and we've also appointed Robeco, a Dutch firm with a strong track record in active ownership and engagement, because we think it's really important not to exclude but to engage with stocks. So for instance as a large fund obviously we are invested in BP, even though it's a fossil fuel company. But today's reality is we all use petrol every day don't we? So, for us it's more about*

engagement to secure change than it is about exclusion, although there are occasional exceptions. So working with Robeco, who also act for others, gives greater clout: if you're going to engage, the greater the shareholding you speak for, the sort of greater the impact of the engagement?

On the other hand we don't collaborate by following blindly proxy voting agencies like ISS to whom so many asset managers outsource the voting for AGMs – and which is a form of collaboration. We prefer to make our own decisions".

Asset owners are investing an increasingly significant part of their portfolio directly in purpose-driven firms and becoming an important catalyst in the move to purpose-driven business.

But 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' questions (and from asset managers) is time consuming and increasingly onerous. There is a need to streamline reporting. **Faith Ward**:

"A number of companies, asset managers and owners recognise that answering twenty or thirty different questions from investors with our approach to purpose is not particularly efficient. It would be better for them to have one report and an infrastructure to support communication. What we're looking for is not just risk/reward – it's risk, reward and impact, It seems to be a growing and important conceptual framework".

Direct investment in private equity and impact funds

This interest in investing for social impact and directly in private equity as means not only to boost financial returns but also to ensure asset owner investments conform to their preferences for purpose and ESG is growing. **Alex Seddon** heads up M&G Investment's rapidly growing impact investment vehicle, Catalyst. He sets out their investment rationale:

"At Catalyst we prefer action over inaction – and we'd rather be largely right than aim for being 100% perfect. But we recognise there's a degree of risk around that, particularly when you are out there stating your purpose in a way that you must do when you're aiming for Impact at scale. So this is not straightforward, but we would rather be leading with purpose, striving always to do the right thing with businesses that in turn are also doing the right thing, operating with the highest level of integrity. Then we try to make sure that we have best in class measurement, reporting and ongoing engagement to drive positive outcomes".

Similarly a number of asset owners expressed the view that investment in private equity made good sense, where there was close alignment between management teams and owners so ensuring purpose was pursued (see our accompanying report on Private Equity showing that an increasing number of PE firms are deploying purpose and ESG investment principles, in part reflecting asset owners' increased investment in them). Some PE houses offer LPAC advisory boards on which asset owners can sit to review purpose, strategy and performance. **Faith Ward** again:

"The purposeful company and private equity are potentially incredibly well aligned, because you're an investor to see the companies thrive over a longer period of time. Philosophically they should be much closer. It seems to have taken quite a while but these days private equity is a lot more receptive to promoting purpose. As an asset owner you're closer to the company or at least you're closer to the general partner, and if you've chosen that general partner because they are in line with your thinking the relationship can work well – and bring real results. I particularly am a big fan of using private markets and private equity to achieve responsible investment goals. Social and climate metrics seem to be getting some traction with the private equity firms. You are in closer touch with management: it just is and feels more direct".

Legal & General is part asset manager, part asset owner. **CEO Sir Nigel Wilson** spells out as a long-term asset owner the interest in investing in start-ups and supporting them scaling – good for them, for policyholders and for shareholders – and all in line with L&G's purpose:

"We invest between three to twenty percent in the shares of thousands of attractive small start-up companies. And because 50% of their leaderships' time is usually spent on fund raising, one of the main ways we help as a partner, is that time goes down to nearly zero. Suddenly all their top people are spending their time on things that really matter for the business rather than trying to raise money. We do gradually increase our shareholding over time.

We've got scale. We have twelve million retail customers and pretty much every institution in the UK either has a relationship with us because we own a bit of their shares or their debts or manage their pension funds or insurance or whatever.

So we can give our start-ups access to customers and if we occasionally let them use our brand name, that x% of the shares are owned by Legal & General, then their stakeholders can be confident that this small company is not going to fall over because it's financed by Legal & General. We can then sample select, improve over time the performance of these businesses and scale them up, and then make them into grown-up, fully fledged businesses – the next generation. We have up to five hundred different companies as start-ups, then thirty or forty different types of scale-ups. For example, people wouldn't even know we own Kensa our ground source heating business. We think ground source heating is going to be important in the future of Britain – and it was right to get behind them for our purpose

of working to create an inclusive economy, for our policy holders and for our shareholders".

Importantly they are all purpose driven. He offers a vivid example:

"A lot of the young companies in which we invest are full of young people who want to be purpose-led. The most senior person in of one our potential investments came in the other day – she was 24, the same age as my youngest daughter – and it was like my daughter talking to me as to whether we sufficiently met her standards to be investors in their company.

Were we really genuine about being a purpose- led organisation?', she asked and wanted to hear the reply from the boss. She was very well prepared, and went away happy that she was getting a good powerful investor who aligned with their purpose. They are not looking to exit in 6 months: they care about doing the right thing and want to have an investor who shares their long-term vision".

It is win/win – and an approach that tends to be more embedded in asset owners. It is asset owners, for example, whose votes tend to be cast more consistently for ESG proposals, moderating executive compensation and are generally supportive of purpose (especially public sector pension funds). Asset managers, notably those directly competing for inflows from individual investors in the retail market, are more 'money conscious' and tend to oppose motions that could lower shareholder returns in any way, although again some retail funds will take purpose and ESG factors into account. There is nuance and variation. Research suggests that these preferences are well embedded and survive over time.[1] It is asset owners to whom we must look to drive the case for purpose-led business forward, including ESG. That is certainly the view of the FCA's **Sacha Sadan**:

"The bigger asset owners are in pole position – they can definitely demand better from their managers. That is why I'm trying to give them the information they need. They could definitely move money more towards the managers that are doing a better job and away from those doing worse. Now they'll say they try. But it's difficult. They haven't got all the data. So we're trying to plug that gap. The one thing that I've found in all my years of working in the system, is that if people think they have the opportunity to win, they will put more resources into the areas that make them do just that. And there are some fantastic players out there.

But if we could advance asset owners really feeling that they are in control and can drive this, it will move quicker. They have all said they are committed. For example most asset owners have now joined the Net Zero Asset Owners Alliance. Net zero is only one part of ESG but if they really held their managers to account, owning the managers that are really pushing on net zero, that could move that element

1 Bolton, Patrick, Tao Li, Enrichetta Ravina and Howard Rosenthal (2020) "Investor ideology" *Journal of Financial Economics* 137(2): 320-352

of the agenda a lot quicker than anyone currently thinks. It won't matter what other regulators or politicians are doing because money will be driven that way".

There are signs that asset owners recognise their responsibility and are ready to work together. In February 2022 **18 asset owners representing £675 billion of assets were provoked into writing to the Financial Times** reaffirming the case for purpose as a governing principle from which both long-term value creation and successful Environmental, Social and Governance (ESG) strategies flow:

"Long-term value is most reliably generated by companies led with a clear sense of purpose that guides their strategy and informs their values. The article by Paul Polman, the former chief executive of Unilever ("Critics of 'woke' capitalism are wrong", Opinion, January 25), makes this point but also describes how the commitments of businesses to pursue purpose, better manage carbon risks and engage constructively with stakeholders are increasingly decried as somehow endangering long-term value creation. We wish unanimously to reassert that our experience, and the evidence, show the opposite.

Collectively we are responsible for more than £675bn of assets ultimately owned by beneficiaries to whom pension funds have a fiduciary obligation to secure the best long-term financial return. We believe that the growing emphasis being placed by companies on sustainability, and the drive to net zero, needs to intensify. Moreover, it is only by honestly engaging with the full range of stakeholders — including consumers, employees and shareholders — that value can be sustained over the long run. To the extent there are difficult decisions and trade-offs, they need to be explicit, open and explained to stakeholders.

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".

This public declaration in support of purpose could and should be built on. Asset owners' attitudes and initiatives are a potentially crucial driver of greater salience and engagement with purpose that could cascade across the capital markets.

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, now promote 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. To be valuable these assets 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.

Nicholas Lyons, Lord Mayor of the CIty of London on sabbatical from chair of Phoenix drives the point home:

> *"We're talking about peoples' financial and environmental health. We would be aligning everybody in this country who has got a pension not only with the success of British business, but also a journey towards a better future".*

This recognition of 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 and sometimes derived from purpose, is analytically distinct. Purpose addresses the 'why' of a company, while the focus of ESG is on policies which – although may help that 'why' to be implemented through promoting environmental, social and good governance 'goods' – 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 want to have a sustainable dimension to their purpose.

This is important as ESG suffers 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, and 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. Indeed, in the view of Legal & General's **Sir Nigel Wilson**, there is now a second chance to capture new technologies and build new companies founded around these principles that must be seized:

"The UK has got a second chance now because technology and science is changing so quickly. There's a point of inflection again, a bit like 2000 when the technology changed massively, or looking back to the 1850s and 1860s when the UK did brilliantly well: Manchester had the highest per capita income of any city in the world as did the UK in its entirety.

Since then, as everyone knows, we've fallen away. There was a great opportunity in 2000, but we completely missed it and all these American and Chinese companies emerged and became huge scalable businesses. We have a second chance now because of everything that's happened; life science is just one part of that, as are the creative industries and clearly another part are the opportunities in climate change".

It is also the view of **Nicholas Lyons**:

"When we discovered North Sea oil, that was Britain's opportunity – but we missed it. The Norwegians did not. They created a sovereign wealth fund which is now worth £1 trillion. But the next opportunity is around this whole wave of new technology. We can't make the same mistake a second time. Maybe the Government should look at diverting proceeds from taxes on 'excessive profits' of fossil fuel companies and renewable energy companies into such a sovereign wealth fund".

Both Sir Nigel Wilson and Nicholas Lyons believe that purpose is integral to seizing this opportunity. Recall Andy Haldane's call to arms in the Introduction: Britain needs companies driven by a profound sense of purpose if it is to respond successfully not only to the twenty-first century's economic challenges, he argued, but also societal and environmental challenges. It is a point with which both Wilson and Lyons agree. Indeed **Nicholas Lyons** wants to see the government create its wealth fund following the lead of the private sector establishing its own £50 billion fund. The funds would be a catalytic transformation to our ecosystem that would address many of the issues raised in this report. We set out his proposals in detail:

"If we're going to invest for growth and for our future, we have to mobilise private sector money intelligently. Britain has got the second largest pension pot in the world, second only to the United States: around £4 trillion in pension funds – but only 7% of it is invested in productive growth assets – in infrastructure, in private equity and in certain kinds of real estate. For reference, the 7 other countries with the biggest pension pots invest on average 19% in those three asset classes. Our savings mentality has become very risk averse. Why is this?

It's because these are 'illiquid' assets, that is, they don't have a daily listed price – but

they are highly productive. One of the reasons companies like ourselves and other big players in the long term savings and retirement arena have been constrained from investing in them is regulation. The recent reforms in Solvency 2 will start to address this. The £2 trillion defined benefit pension system could replace some medium-term corporate bond exposure with long-dated infrastructure loans that would significantly improve returns and free up capital for further investment.

All of the long-term savings organisations are looking at this: in particular we recognise that within the current defined contribution workplace pension pool of £500 billion (and expected to grow to over £1 trillion by 2031) plus SIPP assets of nearly £800 billion, an allocation of less than 5% would provide at least £50 billion to invest in those more productive asset classes.[1]

My vision is that we consolidate investments from diverse pension pots to create a £50 billion Wealth Fund to invest in private equity in our growth economy sectors such as technology, fintech, biotech and life sciences. It would send a very strong message to those companies and entrepreneurs that we're serious about having capital markets here in the UK that can provide the accelerator equity funding that they need. And it would democratise the returns from their success as everyone who has a pension would be a shareholder. Importantly, as it's pension money, the Fund would have long term investment horizons. That obviates the need for investee companies to be looking for quick exits or listings.

And we are really good at science and technology in this country. For example we have seven of the best twenty universities in the world, four of the top ten. We have produced a huge number of great, early-stage companies; we have more fintech companies, more fintech unicorns, in this country than all of the rest of Europe put together, and yet we don't have a single one of those in our FTSE 100. Because they are great businesses, sophisticated capital providers and asset owners around the world – Canadian state pension funds, the Australian 'Supers', US West Coast Investors, sovereign wealth funds – flock to the UK to invest in these businesses and provide the accelerator financing for these vehicles. We do put VC companies in touch with universities, and we put early-stage seed funding in. But that is not the scale of accelerator funding needed, because we've got constraints around what we are happy to have our pension funds invested in – so we don't do that.

1 Figures drawn from Investment Management in the UK 2021-22, The Investment Association Annual Survey September 2022.

An Australian 'Super' (superannuation scheme) recently told me their exposure to these asset classes was around 30%. We're 7%.

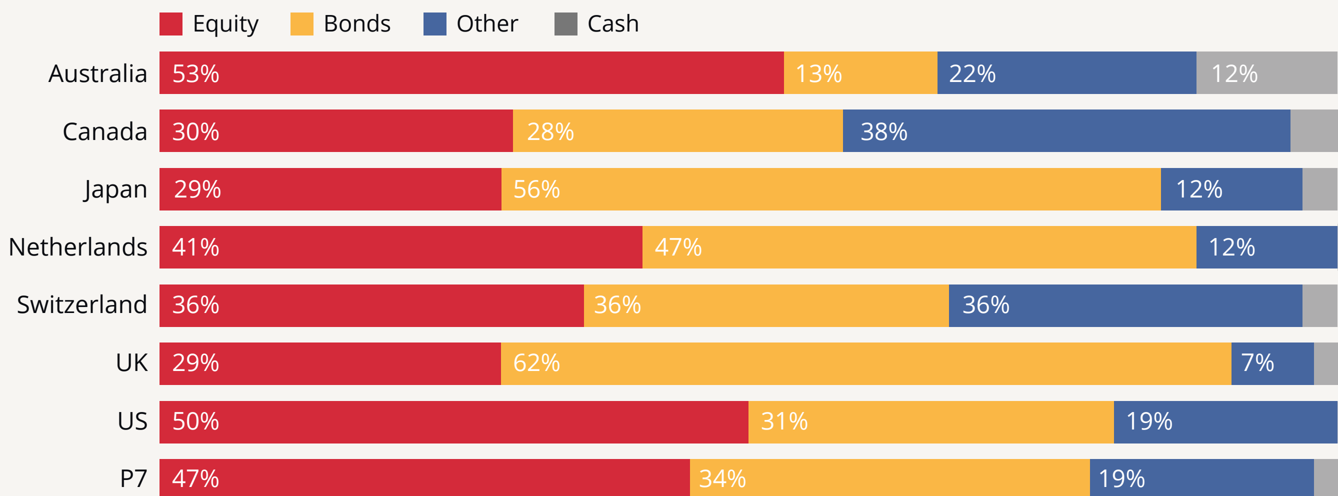
Britain needs to mobilise money and to do that we need to consolidate pension money into a large fund that can then invest in a very large number of diverse assets so we have diversification of risk. We need to do things a bit more collectively in this country around something like this – every DC investor needs to be behind it. We have to create an ecosystem that says we really care about our entrepreneurs staying and scaling their business here. We have to change the narrative about the huge value to the country of creating wealth and jobs: and it is the private sector that must take the lead and 'do' – governments just need to create the environment".

It is a proposal with legs. The accompanying table shows the assets in which varying countries' pension funds invest: the UK has the lowest proportion directly investing in productive assets.

Mark Versey CEO of Aviva Investments, has discussed the concept of a wealth fund as a means to close the gap with Nicholas Lyons. He supports it:

"We support the idea of a wealth fund, and we have discussed ideas like this with Nicholas Lyons and others. The concept of a fund that can invest pension capital in early-stage corporates we think can give very good returns for pensions. People saving for their future pensions are very long-term investors. The timeframe of investment therefore matches the corporates need for borrowing. So theoretically, there's a really good match and investment case for this".

Asset Allocation, Pension Funds



Source: Unleashing capital, Policy Exchange 2022 p17

But he signals a difficulty:

> *"This is really for the defined contribution (DC) pension market. But the difficulty is that this market operates with intensely low fees and is highly competitive between the providers. Decision makers today simply don't want to pay the fees to have these style of investments. The main obstacle therefore is educating the trustees of the defined contribution pension schemes to want to invest this way accepting the associated costs. We as the asset management community, need to better justify the costs and benefits. If you're going to improve the long-term returns by 1% per annum at the whole fund level, then that should justify a higher fee. But at the moment, most DC funds are invested in passive equity so we're a long way from them investing in venture capital. They're not even really investing in real estate, or infrastructure, which should be even easier investment cases to make. Consultants have a big role to play here in helping the asset management community articulate this, because I believe there is a really credible investment case for it. It simply can't be done at existing fee levels".*

Worries over liquidity can be managed, he thinks, but signs off on this note:

> *"There needs to be a really concerted push by the government to help. There's an education piece to get the trustees to actually want to invest in these classes of asset. We need government, asset managers, trustees and consultants, to all work together to find solutions to get something like this off the ground. I think there's a really good idea in here, but it's not just venture capital it is also infrastructure and real estate. We need to solve this for wider asset classes as well".*

RSA CEO **Andy Haldane** also supports the creation of a national wealth fund:

> *"There is a role for something akin to a state development bank or sovereign wealth fund, something that fuses together public and private sources of financing, and which invests purposefully and locally on the innovations of tomorrow that we know will be the wellspring of rises in productivity and living standards the day after. When I look back over the course of history, all the magic has happened on the intersection between public and private sector and civil society. And some sovereign wealth fund-like entity could be the institutional fusion of those three sectors, acting in a purposeful way to fertilise the businesses of tomorrow and ultimately the living standards of the next generation".*

Nicholas Lyons, while wanting the government to launch a wealth fund in parallel with the private sector, is against any notion of fusion. The two funds must stay independent even while being co-managed. He explains:

"I don't want government interfering with private pension money. If they are prepared to create a parallel state pension pot or a sovereign wealth fund that's fine. I want to create a blueprint that they can easily leverage. If government went to the bond markets and wanted to borrow say £20 billion of 30 or 50 year money to put into a sovereign wealth fund, the markets would say that's a brilliant idea. But it is important that we depoliticise it – take it out of the hands of whoever's in No.10 at any particular point in time. And that's the challenge: what politician is voluntarily going to cede control of money that might otherwise be used to prop up failing public services when there is an election in sight?"

To be effective any wealth fund must be part of a broader ecosystem response. There have to be better answers to the problems practitioners are encountering as identified in this report, along with an improvement in ecosystem-wide systems and processes. Companies must get better at linking purpose to strategy and enlisting stakeholders to the cause, so lifting all round performance, and then communicating and reporting the results – so potentially enlisting a critical mass of supportive shareholders. Indeed, in practical terms making common cause over purpose may be the best way of simulating the 'blockholder' effect enjoyed by companies in most other market economies, and also lifting the uneven levels of investor engagement. If British companies cannot have blockholders, then a good second best would be a group of shareholders accepting an anchorage role and committed to their purpose. **Andy Haldane** also sees the proposed wealth fund, which could play an important role as anchor shareholder, as part of wider ecosystem reform including rebuilding demand for British shares from British institutional shareholders and reform of company law:

"Mass flourishing follows from having two I's – innovation on the one hand forging progress but tempered and nurtured by institutions that provide memory and longevity to that process of change, smoothing off the sharper edges of the disruptive forces of the capitalist machine. So we need a recrafting and reformatting of our institutional architecture to make a success of the twenty first century fourth industrial revolution, just as we had to rethink and reformat our institutional ecology when making a success of the first, second and third industrial revolutions of the eighteenth, nineteenth and twentieth centuries respectively.

There are lots of elements prospectively of that new institutional architecture. But to pick just one example, we need to think afresh about whether the institutions for financing our society are fit for purpose, including financing our companies. Too much of that first-line innovation is starved of sunlight, nutrition and financing by our current institutional landscape. There's a deep perversity that Canadian pension funds invest more in British business than British pension funds. And that is a remediable

problem. It's an institutional problem and we need to organise an institutional fix PDQ if we are to rise to those economic, social and environmental challenges.

I do feel purpose needs to be rooted at the statutory or constitutional level. I think now is the time to reconsider legislation in a way that puts purpose much more front and centre in company legislation. This would put stakeholder capitalism front and centre of the new agenda. Soft law (such as corporate governance codes) are all very well and good. They can nudge and nurdle purpose. But if we need a great leap forward then statute and statutory change is what we need".

One business sector where the purpose case is already considerably advanced is the regulated utilities – recall Severn Trent CEO Liv Garfield and her strong commitment to social purpose earlier in this report, along with John Pettigrew, CEO of the National Grid in The Purpose Tapes which we published in July 2021. This is where the government should consider giving the kind of regulatory lead advocated by Andy Haldane and in so doing progress the practice of purpose-driven business. Every regulated utility should be required to write its commitment to the social purpose of delivering whatever vital good or service it provides – water, electricity, gas, transmission in varying grids – into both its license and articles of association. **Will Hutton**, co-chair of The Purposeful Company and President of the Academy of Social Sciences, outlines the case for such public benefit companies:

"Leadership teams and staff alike in the regulated utilities are keenly aware that what they do – especially given that most were formerly nationalised industries – is to provide a good that is essential to life and generally from a position as a natural monopoly. Of course their first obligation must be to deliver that social purpose as efficiently, reliably, cheaply and sustainably as possible from which long run profitability will derive. There can be no ambiguity about their 'reason-to-be'.

This should explicitly be written into every regulatory licence agreement with utility companies, who then incorporate the purpose in their articles of association so that investors and directors alike are crystal clear – whether publicly quoted or owned by private equity or consortia of private investors – that the fiduciary obligation to drive the company forward profitably can only be secured by delivering its social purpose. Corner cutting or actions that put delivering purpose at risk will be constitutionally and commercially inadmissible.

There will be a need for a common materiality base-line for what purpose means in practice, along with a system of independent third party audit and verification – a job possibly to be delegated to a new 'purpose' regulator. Boards should be constituted by directors with proven competence with it always open to the government to appoint public interest non-executive directors if it were to take a 'foundation' share in each utility.

A well structured pyramid of regulatory interventions should be evolved from the current practice, with the starting point public explanations of why targets have been missed ranging to loss of licence for persistent or serious offences. Public benefit companies will be open book, open source and open innovators with a high trust relationship with regulators, investors, consumers and staff alike. Each should establish independent consumer challenge groups to ensure the consumer voice is built into their decision making and each should create a social tariff for disadvantaged consumers. No less than a quarter of their shares should be traded on the London stock market, so there are common standards of accountability and transparency for all. They will create a new asset class of purpose-driven companies – an innovative addition to our institutional landscape that has every prospect of being not only efficient and committed to serving the public, but well regarded".

What unites these proposals is a desire to find points of leverage that shift the ecosystem towards purpose. So, for example, **Nicholas Lyons** makes the point the wealth fund would invest in private equity – forming a bridge between the private and public markets that does not exist at present:

"The Wealth Fund could and should also invest in independent private equity funds specialising in these sectors. Private equity doesn't sit outside this debate about purpose. I sit on the boards of a couple of companies that are owned by private equity firms, and they do focus on this. Of course, there is a more acute focus on tangible shareholder value, and their time horizons are going to be shorter than the time horizons that I am talking about here. But don't assume that just because they're private equity that they don't have a sense of purpose".

Nor should the drive to reshape the ecosystem stop there. Within the ESG debate there is much focus on the E and G – but the S is much less discussed and potential actions foregrounded. This should change. **Clare Chapman**, chair of Acas and co-chair of The Purposeful Company, believes it is an opportunity finally for companies to cornerstone a twenty first century commitment to human capital development as part of the 'S'.

"There is a shift underway in ESG thinking which Covid-19 has helped to accelerate. ***Employees*** *increasingly expect their company to stand for something and labour shortages will mean this pressure is likely to continue.* ***Investors*** *increasingly see a value in ESG if materiality has been well thought through to leverage opportunity and the right strategic risks are mitigated. Evidence is emerging that addressing material ESG dimensions translates into around 10% lowering of the cost of capital. Challenges do*

continue however around the lack of auditing around ESG reporting. The quality of data around human and natural assets is far less rigorous than that around financial assets. Addressing this will enable investors to be more confident in using ESG data for decision making.

***Regulators and government** policy makers see potential in ESG for similar reasons to investors and because it tends to result in companies being active problem solvers in societal and structural issues. For example around environmental pollution, labour and skill shortages and in the degree of diversity and participation in the way companies are led.*

It's worth amplifying the latter point since it is becoming increasingly urgent that obstacles to growth be addressed for the UK to strengthen its competitiveness. The UK now lags behind many of its global peers not just around investment in R&D but also in strategic skill investment which will need addressing. The 2019 McKinsey research on skills forecast that by 2030 2/3rds of the U.K. workforce may need to transition between occupations or skill levels. Population demographics (particularly ageing), consumer preferences and technological change are likely increasingly to lead to shortages amongst highly skilled occupations alongside a narrowing of job opportunities for lower skilled workers.

It is the responsibility of business to take the lead in closing skill and labour availability gaps. But there is also likely to be a role for national and regional government to help ensure the education and development ecosystem evolves and income and benefit policy keeps pace. Given the forecast levels of disruption around skills and labour availability there will increasingly be a need for 'just transitions' – particularly in sectors where workers are disproportionately impacted or with those who have not yet entered the labour market. All this will require strong public/private partnerships to achieve the level of innovation and vision necessary".

Lastly there are two more potential changes that are promising routes to promoting purpose. **Professor Alex Edmans**, quoted earlier in the report, strongly believes that a system should be introduced for allowing shareholders to have a say on purpose at AGMs. He sets out the case:

"If you believe that purpose is fundamental to a company, which a lot of investors and companies claim, then put your money where your mouth is and allow investors to have a view on that – because at the moment there isn't a mechanism for investors to communicate their view. They can say what they want to know about pay, but not the purpose of a company. So how many times do companies talk about purpose rather than just climate? I would argue more. When NatWest says we're going to be a purpose driven

organisation, not a climate driven organisation, climate is part of purpose – one of their three pillars. I think a lot of companies message that purpose is more important, and if they do then the votes should be on purpose, it should not be on just climate.

The argument is wrong that if you don't like the company just sell their shares, that will tell the company that you don't like the purpose. First why wouldn't you apply that to climate, if you don't like the company's stance on climate just sell their shares? But more importantly if you sell shares what message does this send? It doesn't send a clear message. You could be selling your shares for so many reasons.

It could be that you don't like the financial performance, you don't like the transition plan, or you just have another better investment opportunity. It may be that the company is great, but the valuation is just now too stretched.

What is the value of this? It is for investors to communicate their non-financial preferences. Why? Because sometimes there's a tradeoff. Yes, we do agree with growing the pie, and we do agree that many personal things will end up leading to profit. But what if there is a tradeoff? Are investors willing to give companies a mandate to pursue something purposeful, even if there's no financial pay-off to this?

And that's what a say on purpose will do: it will give a clear mandate as to what investors care about. So it might be we would want you to decarbonise, or we want you to keep your oil in the ground, even though that's going to be bad for financial performance. But it could be beyond that. It could be we want you to pay living wages, even though that's going to be bad for your competitiveness – because we think that's an important part of your purpose.

There could be two votes, just like pay has two votes – a vote on the policy and a vote on the implementation. So, with purpose you're going to vote on the statements you agree with and the implementation of how they're put into practice. If it's too much you can combine it into one, but if it's one it should be in both the statement and the delivery".

Corporate governance and reporting have important roles to play. Purpose reporting should be incorporated with strategic reports, not least to eliminate some of the repetition currently in fielding varying investor questions. Directors' duties, picking up on the point made by Andy Haldane, need to be redefined so that fiduciary obligations are understood to mean driving the whole organisation forward around its declared purpose as a means to profitability. Corporate law should

support the proposition that purpose should drive profit. Boards should be organised to take forward purpose and ESG. **Nicholas Lyons** makes the case for sustainability committees:

> *"Businesses have transformed themselves in the last fifteen years around the whole issue of purpose. You would be amazed if you sat in on a board meeting, how much time is occupied talking about purpose, about customers, about doing what's right, about what the societal impact of this is, about communities that we operate in. That's what it's all about.*
>
> *Boards have a risk committee, an audit committee and a remuneration committee: we now need to add a sustainability committee with equal standing You then elevate the importance of sustainability within the organisation – not just ESG, but ESG disaggregated into E, S and G and purpose. You then create an organisational structure of executives underneath that committee who make this their life's work, and you get incredible buy in from the people in your organisation. I would like to put out a call for not only every FTSE 100 company, but every FTSE 250 company, to have a sustainability committee that sits in parallel to their audit and risk committees with equal standing. It will absolutely transform the way they look at purpose because it inevitably goes to the heart of what makes an organisation tick".*

And lastly executive pay; all these proposals will work so much better the more the pay of leadership teams is aligned with the paradigm of purpose and long-term value creation. **Clare Chapman** again with both an appreciation of recent changes, and a caution:

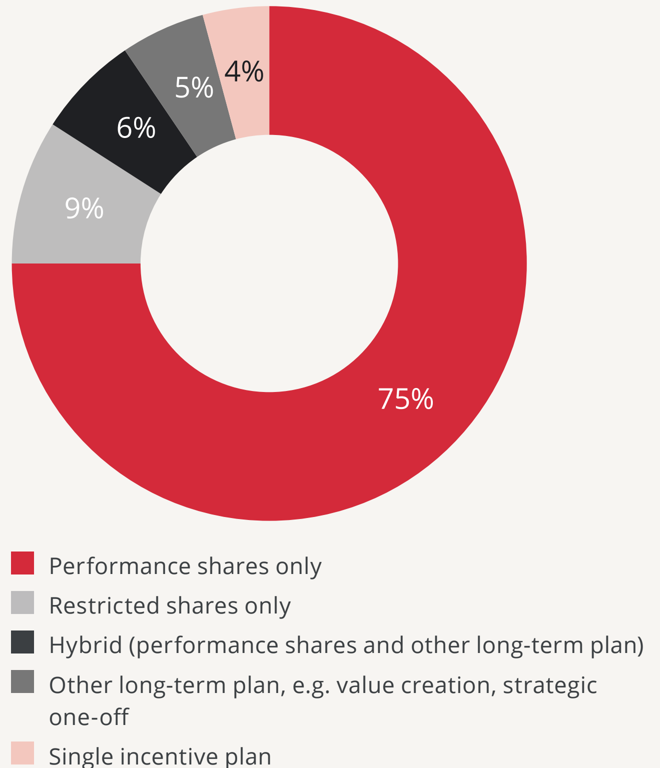
> *"A further area for ecosystem action is around executive pay. The Purposeful Company advocated in our 2016 Report on the need to shift away from traditional LTIPs to 'long-term, long-held stock'. There were also calls for reform from the BEIS Select Committee and from the Investment Association. Progress has been made and in our 2019 Purposeful Company Report we quoted Ian Wright who was the Chair of the BEIS Select Committee (2015-17):*
>
> *'Our Select Committee inquiry on corporate governance and executive pay found that LTIPs were too complex, opaque and prioritised short-term behaviour to benefit executives at the time of vesting over long-term value creation for shareholders. We called for the replacement of LTIPs with long held share awards and I am pleased that this [Purposeful Company] Report shows that newly one in 10 FTSE 350 companies have now moved in this direction (see diagram below). Clearly, there is significantly more to do but the leadership provided by The Purposeful Company and forward thinking companies such as BT, Burberry and Weir Group demonstrates what commitment from the remuneration committee chair towards engaging*

with the shareholder base and leading meaningful change can achieve'.

Overall, through the work of multiple stakeholders across the market, deferred shares have become a viable option for a wide range of companies in the last few years and in particular over the past three years. This was an outcome that was far from certain when we advocated it in 2016. This must be seen as a positive step forward. However, if what emerges is an inflexible restricted stock model, replacing just the LTIP with tightly defined, market-wide perimeters there is a risk that we do not capture the hoped for gains – from pay reform. This would indeed represent two steps forward and one step back. We recognise that the Covid-19 pandemic created a challenging environment for executive pay but it could also be an opportunity to take bolder steps on reshaping executive pay really to incentivise long-term value creation".

These proposals taken together would reshape British capitalism significantly for the better. They are all feasible, some of them simply scaling existing practice. 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 ongoing improvement.

The proportion and structure of Long-Term Incentive Plans in FTSE 350 companies



- Performance shares only
- Restricted shares only
- Hybrid (performance shares and other long-term plan)
- Other long-term plan, e.g. value creation, strategic one-off
- Single incentive plan

Alternative incentive plans
65 FTSE 350 companies operate an alternative to a performance share plan:

- A restricted share plan as the only LTIP is the most common alternative approach (24 companies)
- 17 companies operate a single incentive plan, either making awards based on annual performance which are deferred over 3 or more years, or making awards subject to performance over multiple years
- 11 companies operate combination of plans, typically performance shares with either restricted shares or share options
- 13 companies have implemented some other form of LTIP, usually a strategic one-off plan or a value creation plan

Source: Deloitte 2022

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.

Summary of *recommendations* (continued)

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.

Appendix

A group of researchers at Harvard Business School in collaboration with the CECP Strategic Investor Initiative recently undertook a pathfinder investigation into how well-presented long-term plans revealed at CEO Investor Forums organised by the Strategic Investor Initiative were received by investors.

Although they stress that their findings are necessarily preliminary, based on only 17 companies who presented at the forum, the results did show that investors were persuadable and reacted positively to long-term plans. Companies' share prices rose by an average of 1.83% after their presentations. These findings are consistent with other studies that show positive market reaction – and increases in share activity – following senior management and CEO conference presentations.[1]

Thus a survey of investment decision makers carried out by FCLT Global found that 86% of respondents would like companies to use a minimum three-year time horizon for forward-looking targets. In addition Harvard's Jody Grewal (2019) finds that even the softest forward looking information can be value relevant: for example, unaudited corporate sustainability reports disclosed 2-3 years before publication in the main financial report may still contain reliable information about future revenues from low carbon products. Investors, in short, value long-term plans.

So what constitutes an effective long-term plan? The figure below sets out nine themes identified by the Harvard team that if all addressed will go a long way to meeting investor demands – financial performance, the allocation of capital,

1 Bushee Brian, Michael Jung and Gregory Miller (2011), "Conference Presentations and the Disclosure Milieu" *Journal of Accounting Research*, 49(5),1163-1192; Whittington, Richard, Yakis-Douglas, Basak and Kwangwon Ahn (2016), "Cheap talk? Strategy presentations as a form of chief executive officer impression management" *Strategic Management Journal*, 37(12), 2413-2424

Nine themes and 22 underlying issues to guide an effective long-term strategic plan

Source: Kotsantonis et al. (2019)

market trends, competitive positioning, risks and opportunities, corporate governance, corporate purpose, human capital and long-term value creation. They then break down the themes into 22 underlying issues as set out below.

However closer examination of how well companies report on these 22 underlying issues which together constitute a good plan was disappointing. The researchers ranked disclosure in four categories: no disclosure, boilerplate, backward-looking and forward-looking metrics.

The first column of the table below ranks the plans that had forward looking metrics, but a glance down the column is telling: only within the headings of competitive positioning, market trends and profitability was much effort made.

Most of the reporting in these plans is backward looking, consisting of lagging indicators or worse tends to the boilerplate. With very few exceptions, companies struggle to provide specific actionable disclosures with a future time horizon – in particular there was no information at all on any dimension on corporate governance, while mainly regressing to boiler plate statements on purpose. But importantly market reactions are especially positive when companies disclose specific and actionable information on competitive positioning and, on the few examples it occurred, purpose.

Two med tech companies – Beckton Dickinson and Medtronic – are singled out as exemplar companies that provide strong forward-looking and specific information.

Ranking of the timeliness and materiality of the 22 underlying issues

Theme	Issues	MF	MB	B	ND
Finance Performance	Capital efficiency and profitability	9	7	3	3
	How leveraged will company be in years ahead?	1	0	0	21
	Revenue growth	2	4	5	11
Capital Allocation	Capital allocation plan/framework underlying the long-term strategy	3	7	8	4
	M&A discipline	0	7	5	10
	Investments in R&D and CAPEX	1	4	3	14
	Plan for excess cash	4	7	5	6
Trends	Market trends	12	7	2	1
	Mega-trends	4	3	10	5
Competitive Positioning	Long-term value drivers (>7 years)	9	0	13	0
	Medium-term value drivers (2–7 years)	9	0	6	7
	Short-term value drivers (<=2 years)	9	9	3	1
Risks and Opportunities	Assessment of financially material ESG issues	1	4	0	17
	Risks: how are financially material risks managed/overseen?	1	7	3	11
	Opportunities: how are financially material opportunities seized?	6	7	9	0
Corporate Governance	Executive compensation: alignment with long-term strategy	0	7	2	13
	How will composition of board guide long-term strategic goals	0	7	3	12
	Role of board in setting corporate strategy, setting incentives for and overseeing management	0	5	6	11
	Plan for shareholder engagement	0	2	8	12
Corporate Purpose	What is the corporation's purpose/is it aligned with LT strategy and goals?	2	3	14	3
Human Capital	How is human capital managed over the long-term?	5	7	7	3
LT Value Creation	Value of strategic partnerships/ improving operational ecosystem	3	5	12	2

ND= No disclosure B= Boilerplate MB= Metrics Backward MF= Metrics Forward

The Purposeful Company
thepurposefulcompany.org
info@thepurposefulcompany.org

All rights reserved © The Purposeful Company. No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form without prior written permission of the publishers.