THE ESG FILES

EXPLORING THE INVESTMENT CONSIDERATIONS OF ESG MATTERS

REDEFINING THE PURPOSE OF A CORPORATION

In August 2019, 181 members of the Business Roundtable – a Washington, D.C.-based lobby group consisting of CEOs of the world's most influential corporations – updated its Statement on the Purpose of a Corporation, for the first time acknowledging that business decisions should deliver value not just for shareholders, but for all stakeholders, including customers, employees, suppliers, communities and the environment. Reaction has run the gamut from applause to skepticism.

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Mark: Let's start with reactions to the Business Roundtable's statement. As investment practitioners, how do you interpret it?

Jeremy: The focus of the Roundtable on broader definitions of value creation fits well with how we look at companies for the long term. We take a business-owner approach to investing — our average holding period is more than seven years — so we have to be concerned about the long-term risks to future cash flows. That includes political and regulatory considerations, and certainly ESG considerations.

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Aaron: We should also acknowledge that this is not necessarily about defining a particular social purpose for any one organization, which can also be a good thing, but really more about saying that we're widening the lens of value creation to go beyond considering shareholders in isolation. I think it's also important that this is coming from CEOs, as opposed to public relations as it emphasizes the 'tone-from-the-top' mentality of the initiative.

Drew: I would add that if you look at the strategies of the businesses that we invest in, many are already focused on multiple stakeholders. For example, PepsiCo, a company that has, behind the scenes, focused on improving the quality of its products for consumers by reducing sugar, saturated fats and sodium. For a long time, the company has also worked on environmental sustainability in terms of reducing its water intensity. So, in some ways, it's a reflection of what's already happening at higher quality companies, and that on the margin, we hope to see more progress as a result of formalizing the statement of purpose.

Mark: How do you evaluate implementation, i.e. assess how companies will walk the walk?

Jeremy: There will be companies that take the new 'purpose of a company' mission seriously, while others will continue to focus on the short term, driven by the vagaries and demands of the market. It's the job of an active portfolio manager to meet with companies, to

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understand their cultures and management teams, and to track their processes to see whether they've truly embraced the idea. Microsoft is an example that comes to mind. The company is one of the leaders in tech for enhanced benefits such as maternity leave, and they've rolled out those benefits across their contractor work force as well, which is important in terms of equity. This goes way beyond just having fancy food in the company cafeteria in terms of employee engagement, talent attraction and retention. Microsoft has also been instrumental in contributing to the communities in which they operate – it recently donated more than $500 million USD to deliver affordable housing in the Puget Sound area.

Drew: This is about managing for more than just profit in the quarter. It's about the long-term sustainability of the business. Going back to the example of Pepsi, it's also imperative for companies to remain relevant to consumers today who need to feel connected to their products. Consumers need to feel like the product is furthering the world around them or inspiring a feeling of pride to hold that product in their hands.

Jeremy: I can think of other companies such as MasterCard and Verisk, which have extremely strong competitive positions – so much so that they could certainly boost near-term profit by taking business away from the other members of their value chain, either suppliers or customers. But they don't do that because abusing the other members of the value chain could eventually attract legal or regulatory attention, damaging the long-term profitability of the business. Instead, Verisk and MasterCard invest heavily in innovation, not only so they can sell more and grow their own businesses, but also so they can offer success to their customers and others. The philosophy of these two companies is "Let's grow the entire pie." In fact, they take a slice of commission on that success.

Mark: How does this fit into the Canadian context?

Aaron: This aligns well with the evolution of a board of directors' legal fiduciary duty over the past decades in Canada. While case law here already supported considering various stakeholders, the federal government updated the Canada Business Corporations Act this year to state that directors and officers of a corporation may consider the environment, the long-term interests of the corporation, and interests of shareholders, employees, retirees and pensioners, creditors, consumers, and governments. Although these kinds of legal clarifications don't seem like major catalysts, they can act in the same spirit as the Roundtable's statement and help to push the global conversation forward. Another example of a legal nudge catalyzing a new level of conversation in sustainability was the change to Ontario pension law that mandated asset owners ask their investment managers about how they incorporate responsible investing into their decision-making.

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Mark: So how do you connect this with integrated ESG analysis?

Drew: I often see companies that have a great sustainability strategy, but the sustainability team is separate from the operators. A company that takes an integrated approach is more likely to succeed. Think of Costco, where their employees are the number one asset. Compared to other retailers, Costco compensates its employees generously and provides full health benefits, resulting in very low levels of turnover, better client satisfaction and a loyal customer base. This is a central part of the investment case for Costco, and the sustainability of its competitive advantages.

Jeremy: I want to emphasize that the way we evaluate a company on its sustainability is a customized process specific to the company. Three points to consider: First, we build and use proprietary tools to get a quantitative sense of the numbers behind a company's commitment. Second, there are qualitative aspects, so it's also important to do a cultural analysis. We can only glean qualitative data points through going out and meeting with the company, its competitors and its customers to assess what's going on behind the numbers.

And finally, where we see that a company can do better, we can actually be influencers. We take proxy voting very seriously. In some cases, Jarislowsky Fraser has been a shareholder in companies for decades. Companies recognize that we're a long-term partner. We can be a sounding board. We can be helpful in sharing best practices.

Aaron: Accountability to a wider set of stakeholders is an important sustainability concept. The challenge is measuring performance and progress in terms that can drive investment decisions. Although we aren't dogmatic about only using factors that fit on a spreadsheet, we are focused on linking our analysis to long-term value creation by determining if a sustainability factor is material. As analysts, we use our industry knowledge, experience and judgment to determine materiality. However, measuring relative or absolute progress requires consistent and comparable disclosure. I would point towards emerging standards, such as SASB and TCFD, as a way to focus the lens of materiality and financial impact. The more that companies can align their disclosures with sustainability standards like SASB, the easier it becomes for analysts to engage in meaningful dialogue across companies within an industry and make investment decisions on behalf of our clients. In doing so, the leaders will rise to the surface, best practices will propagate and the link between sustainability and value creation will be better articulated.

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Mark: So to recap, the updated statement of the purpose of a corporation has been a welcome step in advancing corporate awareness of and responsibility for sustainability issues. Evaluating how companies will carry out their purpose statement remains largely a bespoke process, but companies can differentiate themselves by embracing emerging disclosure standards. Thank you to all panelists. It's been a highly interesting discussion on an important topic.