“Long-Termism and the Role of the Firm: Building Blocks”

Professor Gordon L Clark
University of Oxford
October 19th 2016
Acknowledgements

• This presentation is based upon our research on the environmental strategies of corporations and institutional investors. The author is the environmental advisor to Diageo Corporation, is on the advisory board of Arabesque Asset Management, and consults to a number of institutional investors on governance and management. None of the comments made in this presentation should be construed as relating to, or representing the experience of, these organizations or other organizations that participate in Smith School research programs.
Expectations I

• Much is expected of major corporations viz their environmental performance
• Their contributions to social justice and welfare at home and abroad
• Going beyond regulatory requirements to much more - witness the expectations of NGOs etc
• Countermanding Friedman’s aphorism about the “responsibility” of business (to make a profit).
Expectations II

- Institutional investors are also increasingly active in this space
- On the risk-management side and/or on the ESG metrics side of the value proposition
- Being about anticipating short-term ‘shocks’ to their investment strategies e.g. BP, VW, BHP
- Or reaping the benefits of long-term investment strategies focused on ESG.
Risk-Management I

• At issue is how to identify companies that ‘cut-corners’ and could destroy value
• Three factors related to governance and management are observed as important
  – Authority for enterprise-wide performance
  – Information on enterprise-wide activities
  – Financial capacity to solve shortfalls in performance short-term and long-term.
Risk-Management II

- ‘Public’ corporations may not be effective custodians of environmental sustainability
- Short-termism on both sides of the market may undercut the factors driving performance – authority, information, and fiscal capacity
- The threat of intervention by activist investors may lead to stripping out internal capacity
- Leading to greater risks of adverse ‘events’ in the largest corporations.
ESG I

- Evidence suggests that ESG is correlated with LT above average financial performance
- Reporting has become an industry with intermediaries dominating the metrics
- Driving companies to collect data, benchmark data, ensure third-party validity of data
- Against the background of debate over what ESG means in theory and practice.
ESG II

• Governments have been reluctant to define or regulate ESG (e.g. UK Companies Act 2006)
• Commercial interests dominate the value chain, including validation and certification
• Even so, it’s a ‘movement’ that has made great progress – witness State Street
• Underpinning many of the boutique value investors like Generation etc.
Looking Forward I

• Risk-management and ESG may be simply adding to the complexity of doing business
• When there are compelling pressures for short-term market returns
• Might private corporations be better long-term custodians of the environment because of their insulation from financial markets?
• Equally, is going private a way to avoid accountability e.g. the fossil fuel sector?
Looking Forward II

• In any event, a long-term perspective requires ‘radical’ thinking
• Driving out of business fossil fuel companies (and the like) by regulation and by bankruptcy
• Investing in new technology companies, venture capital and private equity etc.
• A very different kind of responsible investment with very different ESG profiles.
Conclusions

• Many of the largest public corporations are short-term oriented, and lack patient investors
• Long-term investment is transformative for companies and for investors
• Challenging both to be adaptive and risk-taking in ways that focus on pathways to the future NOT assuming the present is the future
• Requiring ‘investment’ on both sides of the market for corporate control in capacity to innovate.
References


