Big Investors Call for Company Attention to Social Purpose: What Next?

By N. Craig Smith , INSEAD Chaired Professor of Ethics and Social Responsibility, and Markus Scholz, Endowed Chair of Corporate Governance and Business Ethics at FHWien & INSEAD Visiting Scholar

BlackRock CEO Larry Fink's pro-CSR stance needs clarity and muscle.

> "*To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate." – Larry Fink, CEO of BlackRock*

The world's biggest investment firm, with US$6.3 trillion assets under management, has declared that business must have a social purpose. Larry Fink, CEO of BlackRock, in his annual letter to CEOs, said that business needed to make "a positive contribution to society" to warrant BlackRock's support.

The **letter** is a call for corporate social responsibility – especially as stretched governments have given way to business: “We also see many governments failing to prepare for the future, on issues ranging from retirement and infrastructure to automation and worker retraining.”

“Companies must ask themselves: What role do we play in the community? How are we managing our impact on the environment?” Fink writes. He suggests that CEOs should ensure their companies have clear, transparent strategies so that performance can be sustained through understanding “the societal impact of your business as well as the ways that broad, structural trends…affect your potential for growth.”

To be sure, long-term value creation is a central part of his message, but serving all company stakeholders is deemed essential to that. Fink also calls on boards to “assume deeper involvement with a firm’s long-term strategy”, asserting a critical role for board members in articulating business purpose and social responsibility.

Most **reaction** to the surprising letter has been **favourable**. The move towards greater corporate responsibility has been **growing** globally since 2005. Vanguard’s **Bill McNabb** has also recently sent a letter to CEOs saying, “For too long, companies have sacrificed long-term value creation to generate short-term results.” Forbes magazine believes this is a **“ watershed moment”** of corporate responsibility.

Like Shell backing down in the face of Greenpeace’s protest over the **Brent Spar** **platform**, this could be a sea change in corporate responsibility. Greenpeace occupied the North Sea oil buoy to draw attention to the possibility of pollution if it were disposed of at sea. Shell, after initial resistance, realised that it had to back down for the sake of all its stakeholders. While there were also environmental (as well as health and safety) concerns with Shell’s alternative on-land solution and questions about how much pollution would ultimately have been caused by sinking the buoy at sea, the oil giant’s capitulation highlighted the shift to a new era in social responsibility with concerned NGOs seen to have the power to leverage threats against the corporate licence to operate.

Now, it seems, mainstream investors are getting more involved in questions of social purpose. Could this likewise be a watershed moment in corporate social responsibility or is it just a flash in the pan?

Greenwashing or authentic business model?

Some are asking is this a marketing ploy or a more substantial shift towards corporate responsibility? Critics may believe that there is an element of **"greenwashing"** – social and environmentally friendly PR – so that the firm appeals to a broader audience. Or this could be a defensive move because some of BlackRock's investments may be seen as questionable relative to social purpose. The firm has investments in **tobacco** and gambling stocks, for example. And Fink has said that staying away from so-called sin investments is not his goal. "Our job is to respond to what our clients need," he recently told **CNBC**. However, last year's **letter from Fink** mentioned ESG (environment, social and governance), perhaps as a warm-up to this year's stronger and more explicit message.

The big surprise is that BlackRock, an institution that some might assume would solely advocate for companies maximising shareholder value, has a CEO who recognises that other stakeholders may also need attention: "Companies must benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate." Fink no doubt understands that in order to maximise long-term sustainable returns, companies do generally need to give attention to social purpose. To the extent that this is true, attention to social responsibility can be aligned with maximising shareholder value, at least in the long term. Nonetheless, it does seem to be the case that there is something more than long-term shareholder value at stake, if only implicitly, in Fink's call for firms to benefit all stakeholders. The test case, of course, is how he would respond when a business that benefits stakeholders does *not* also bring long-term value creation for the business.

Assuming a positive motivation, perhaps BlackRock aims to lead by example. The letter could be part of a possible broader collective action in which investors come together around a social responsibility agenda. This is seen in the emergence of **responsible CEO movements**.

Until **recently** BlackRock has been seen as a largely **passive** investment firm, investing in profitable indices with low management costs. Fink's letter highlights the fact that, as a passive investor managing index funds, it cannot divest stocks in companies that make up part of the index. Nonetheless – and given the increased use of index funds – he argues for a more **activist** investment stance.

Naturally, the CSR community has been overwhelmingly **positive** in its response to the letter. The Case Foundation's **Jean Case** responded to the message of social purpose with "this is leadership".

Vision and execution of social purpose and social responsibility

The big unanswered questions for us are what does BlackRock mean by social purpose and social responsibility and what will it do about it?

Fink has thrown down the gauntlet, advocating social responsibility and social purpose. But do Fink and Blackrock have a clear vision of social purpose and social responsibility? Social responsibility in relation to the investment firm itself and to its assets are separate issues. BlackRock has had metrics for measuring "the social and financial returns" of its investments for several years – it does so with its Impact product line. Perhaps Fink plans to use these tools across all the company? Or the firm could use social responsibility **rating agencies** to determine which stocks are consistent with their vision of social purpose and which are not. However, even the ratings agencies may not be so transparent, according to a recent report, **"Rate the Raters"**, which evaluates their credibility. As well as sending out an eyebrow-raising letter, BlackRock would serve the financial community well with clearly defined goals and a transparent process.

A leader in this is **GPFG**, the giant Norwegian pension fund. It has transparent indicators and procedures about how it handles social responsibility, especially violations of human rights. It also has a public list of **excluded companies** from the fund. BlackRock could certainly look to emulate elements of GPFG's approach to socially responsible investing.

With a clear definition of social responsibility and social purpose, BlackRock can screen out the companies that aren't consistent with that vision, at least in its actively managed funds (US$1.7 trillion). While it is unlikely that BlackRock would divest from "sin" stocks like its **weapons**, tobacco and gambling interests across indices, engagement with these companies is possible – and seemingly on the cards if Fink's letter is to be taken at face value.

BlackRock's next steps

The announcement that BlackRock demands different priorities from its clients and assets appears to herald a broader commitment to social purpose. While this is to be applauded, we must ask: Is BlackRock actually going to do anything beyond this announcement? There is an implicit threat in the letter that if companies are not aligned with social purpose, BlackRock will not invest in them. Thus, Fink and BlackRock appear to have committed to doing more. How will this be implemented? We are eager to see *how* BlackRock and Larry Fink will live up to their promise of demanding a social purpose and social responsibility from the assets they hold.

We believe BlackRock should:

- *Lead by example and via collective action in order to align the industry in establishing and acting on concrete norms for socially responsible investing*
  One strategy for change is engagement, as Fink's letter acknowledges. Rather than backing off any stock that isn't consistent with social purpose, firms could work with those stocks that are in some way redeemable to try to change their behaviour. The Norwegian fund GPFG reinstates previously excluded companies once they make the necessary changes. One example is **DRD Gold**, a South African mining company which GPFG had excluded due to environmental damage from several mines in Asia; after DRD Gold divested from these mines, the decision to exclude the company from the fund was reversed.

- *Do more to define and measure social responsibility*
  There are different metrics for corporate social performance, though they are inevitably less clear-cut than those on a balance sheet. BlackRock and other investors could build on the work of social responsibility rating agencies, such as Vigeo Eiris, or the Principles for Responsible Investment, which provides **reporting tools**, including one for asset owners and investment managers to assess the responsibility of a given investment.

- *Clearly communicate expectations on social responsibility*
  Define clear communication policies to be followed for companies that do not show sufficient social performance (or violate certain clear-cut social responsibility criteria).

- *Divestment*
  Follow phased divestment steps (at least with actively managed funds) when engagement ultimately fails, with the holding reduced to zero in the final phase.

- *Advocate board role*
  Urge companies to establish social responsibility as a clear governance expectation of company boards, including board responsibility for defining the company's social purpose and determining sound measurement and reporting of social and environmental performance.

N. Craig Smith *is the INSEAD Chair in Ethics and Social Responsibility, the Programme Director of the INSEAD* ***Healthcare Compliance Implementation Leadership Programme*** *and a specialist professor at the INSEAD* ***Corporate Governance Centre****, as well as a member of the Scientific Council of social responsibility rating agency* ***Vigeo Eiris****. His latest book (with Eric Orts) is* **The Moral Responsibility of Firms***.*

Markus Scholz holds the Endowed Chair of Corporate Governance and Business Ethics and is Head of the ***Center for Corporate Governance and Business Ethics*** *at* ***FHWien*** *(the University of Applied Sciences for Management & Communication, Vienna). He is also a Visiting Scholar at the INSEAD Social Innovation Centre.*

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About the author(s)

N. Craig Smith is the INSEAD Chaired Professor of Ethics and Social Responsibility. He is also Academic Director of the INSEAD Ethics and Social Responsibility Initiative (ESRI).

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