Stakeholder Capitalism Meets Shareholder Activism

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Introduction

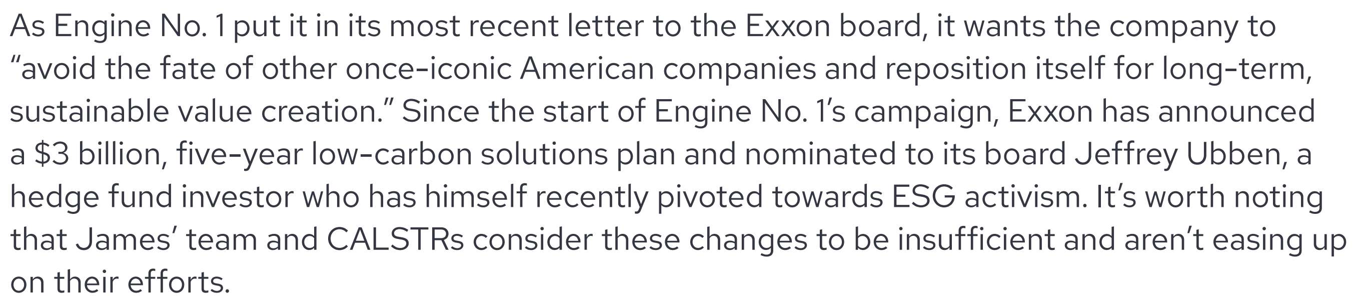
For the past few years, the battle between stakeholder capitalism and shareholder primacy has been a regular topic in the financial news, and particularly since The Business Roundtable “redefined the purpose of a corporation” in 2019. As the head of an organization whose primary mission is to build an economy that works for all Americans, I can assure you that this so-called “battle” is actually rhetorical, and often presents a false dichotomy. Stakeholder capitalism and superior shareholder performance are, in fact, very much aligned.

The gradual rise of activist investors embracing this perspective bears this out. Both JUST Capital and these “ESG Activists,” as we can refer to them, believe that companies that thrive over the long term do not treat other “stakeholders” – like workers, communities, and the environment – as expendable resources or costs to be minimized or passed on to society. Rather, they believe that investing in these other, essential elements of corporate performance, to create value for them, is a better path to long-term success. As the United States moves toward mandatory reporting standards around climate and human capital, companies are being encouraged to recognize their stakeholders as drivers of value and adjust accordingly.

The State Of Play

The ESG industry is expanding dramatically, pushing corporations to address everything from climate risk to diversity, equity, and inclusion (DEI) imbalances within their organization. The chief motivation for this is not moral or political, it is economic.

Take the new investment firm set up last December by hedge fund veteran Chris James, Engine No. 1. They launched with the Reenergize Exxon initiative, in collaboration with pension fund giant CalSTRs, with the aim of pressuring ExxonMobil to invest more heavily in the inevitable energy transition away from fossil fuels and towards clean energy. An interesting thing about the initiative is that you won’t find the acronym “ESG,” let alone “stakeholder capitalism,” in its material. But that doesn’t mean it doesn’t connect directly to both. Yes, investing more heavily in clean energy will benefit the environment, but the initiative is built around the idea of bringing value back to the company’s shareholders, after a prolonged period of underperformance not only against the S&P 500 but each of its rivals.



As Engine No. 1 put it in its most recent letter to the Exxon board, it wants the company to "avoid the fate of other once-iconic American companies and reposition itself for long-term, sustainable value creation." Since the start of Engine No. 1's campaign, Exxon has announced a $3 billion, five-year low-carbon solutions plan and nominated to its board Jeffrey Ubben, a hedge fund investor who has himself recently pivoted towards ESG activism. It's worth noting that James' team and CALSTRs consider these changes to be insufficient and aren't easing up on their efforts.

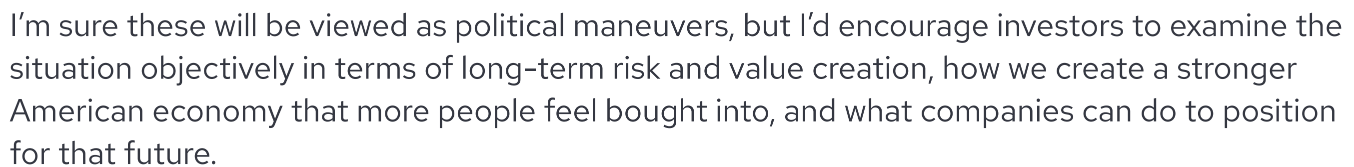
On the diversity side, institutional investors have been aligning with the public – whose voice on business matters is represented in JUST's regular polling, done in tandem with The Harris Poll – and pushing companies to build inclusive cultures where all employees are given the same opportunities for advancement and are well represented throughout the org chart. Here again there is a growing body of evidence that inclusive cultures lead to industry outperformance over the long term and are a powerful source of shareholder value. McKinsey makes a compelling case for this in last year's report "Diversity Wins," which found "there is a substantial performance differential – 48 percent – between the most and least gender-diverse companies" and for racial and cultural diversity, "companies in the top quartile [i.e. the most diverse] outperformed those in the fourth by 36 percent in terms of profitability in 2019, slightly up from 33 percent in 2017 and 35 percent in 2014."

Last year, JUST helped New York City Comptroller Scott Stringer, in his role as steward of three significant pension funds, request that S&P 100 companies publicly disclose race, ethnicity, and gender data they are required to file in EEO-1 reports. We saw companies like Amazon, General Motors, Goldman Sachs, and Pepsico step up to do this before year end, and more have continued to do so (JUST's "CEO Blueprint for Racial Equity," co-written with FSG and PolicyLink, has provided a clear pathway of action for many companies seeking guidance on the subject). Fourteen of the world's largest asset managers, representing $26 trillion in AUM, also announced in February that they would be releasing their EEO-1 data if they hadn't already and would be requiring companies in their portfolios to do the same.

Similarly, the big three asset managers, BlackRock, State Street, and Vanguard all made public commitments to measuring diversity within their portfolio companies with intent to vote against director nominations that don't meet diversity requirements. Even the State of California is adopting a law requiring public companies headquartered in California to have at least one Director on their boards from an underrepresented community by the end of 2021.

An Opportunity To Rethink Value Creation

Biden's SEC is positioning itself to accelerate this new era of ESG investing. Both SEC chair nominee Gary Gensler and acting chair Allison Herren Lee have proclaimed their support for mandatory climate and human capital disclosure, and the agency recently created a task force to police ESG and a new position to specifically oversee ESG and climate risk.



I'm sure these will be viewed as political maneuvers, but I'd encourage investors to examine the situation objectively in terms of long-term risk and value creation, how we create a stronger American economy that more people feel bought into, and what companies can do to position for that future.

This is why, for example, JUST Capital has partnered with PayPal, the Good Jobs Institute, and the Financial Health Network to ask CEOs to make worker financial health and security a C-suite priority and to provide them with the tools and resources to perform a Worker Financial Wellness Assessment. The team's collective research has found that with higher turnover and lower productivity, among other issues, it is actually more expensive to run a company whose customer-facing employees are struggling to get by financially.

The Wall Street Journal recently highlighted this connection between paying workers more and a healthier bottom line, citing research from Harvard that examines what happened at an anonymous Fortune 500 online retailer that raised wages from $16 to $18. The key takeaway: "Prior to the increase, employees moved an average of 4.92 boxes per hour. A $1 pay increase boosted this figure by a third of a box. Higher wages also led to a large drop in employee turnover: a $1 increase reduced the quit rate by 19%." The study found similar productivity and turnover improvements when wages were raised for the company's customer service representatives as well.

This illustrates perfectly what stakeholder capitalism is all about. Investing in workers – a critical stakeholder in any company – by increasing pay not only improves workers' lives, it more than pays for itself via improved productivity, reduced costs relating to hiring and training new employees, and other benefits (greater employee engagement, happier customers, and more).

Perhaps now more than at any point in recent history, companies know that performance leadership across respective stakeholder categories and issues are inexorably linked to superior long term shareholder value creation. Activist ESG investors have already recognized this and are positioning accordingly. By examining your portfolios through this lens, and making the necessary adjustments, you can, too.

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