Our approach to engagement on corporate strategy, purpose, and financial resilience

Investment Stewardship

BlackRock Investment Stewardship (BIS) engages with companies to promote sound corporate governance and sustainable business practices that can help drive the long-term financial returns that enable our clients to meet their investing goals. BIS believes that companies that align their strategies with a clearly articulated purpose are better positioned to weather shocks and disruptions, and in turn, stay focused on long-term value creation.

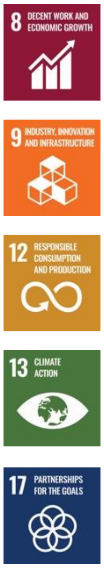
In his annual letter to CEOs, Larry Fink, BlackRock's Chairman and CEO, has for several years highlighted issues that are pivotal to long-term value creation, such as capital management, long-term strategy, purpose, and climate change. Year after year, it has become crystal clear how these issues connect to long-term value creation and influence a company's ability to endure short-term challenges and achieve long-term growth. Companies that develop deeper connections to their key stakeholders and ground their strategies in a strong sense of purpose are better placed to respond to changes fast and, at the same time, build financial resilience to help endure future shocks.[1,2]

BIS does not seek to dictate a company's strategy. That is the responsibility of its board of directors and management team. We do, however, expect companies to have a long-term corporate strategy that accounts for sustainability risks and effectively balances the interests of its stakeholders. We also expect companies to provide clear and comprehensive disclosures to help long-term shareholders understand and assess their strategy and to make informed investment and voting decisions. Consistent with our fiduciary duty, BIS will engage with companies to understand their unique approach to strategy, purpose, and financial resilience, and to signal concerns about sustainability factors that may affect long-term performance, and in turn, our clients' long-term economic interests.

This commentary explains our views on corporate strategy, purpose, and financial resilience, and describes our engagement approach on these topics.

Corporate Strategy, Purpose, and Financial Resilience as Investment Issues

In our experience, purpose-driven companies that work towards integrating sustainability into their long-term strategies and effectively balance the needs of their stakeholders have been better able to attract capital and build financial resilience to weather short-term shocks and deliver long-term, durable profits for shareholders. In our company engagements on corporate strategy over the past year, BIS found increasing recognition of our conviction that companies with a credible long-term strategy, founded on a clearly articulated purpose, will generate more long-term value and be rewarded by patient, long-term capital.[3] At the same time, the COVID-19 pandemic exposed multiple risk factors – the effects of climate change, economic inequality, and racial injustice, among others – that accelerated a global reallocation of capital.[4] In some ways, the pandemic supercharged investors' understanding of, and interest in, sustainability-focused companies, a trend that we expect will continue to grow in the coming years.[5]



UN SDGs alignment

We believe that there is significant intersection between many of the topics that we discuss with companies and aspects of these five Sustainable Development Goals (SDGs).

BIS believes that strategy should be informed by a company's purpose and be aligned with key stakeholders' interests. Boards and management teams that overlook purpose and key stakeholders may face operational, financial, and reputational risks. Even before the global pandemic spread in 2020, we observed an evolution from traditional corporate strategies that relied substantially — if not entirely — on conventional financial metrics to gauge effectiveness to a more purpose-driven approach to corporate strategy. Notable examples of this shift include the U.S. Business Roundtable's Statement on the Purpose of a Corporation[6] and studies that report rising expectations for companies to contribute to solutions that address issues such as training for the jobs of the future, automation, income inequality, diversity, and climate change, among others.[7]

A long-term strategy should reflect both industry-and company-specific dynamics. Every industry has its own cycle, and each company is unique. As a result, we ask companies to succinctly explain their long-term strategic goals, the milestones against which performance can be assessed, and any obstacles incurred or anticipated. We believe that companies that clearly and credibly set out a long-term corporate strategy will be better able to focus on creating value because long-term shareholders can act as a buffer to short-term pressures on management.

As observed in 2020, it is likely that long-term plans will shift in light of fast-changing operational, economic, and societal conditions. In those situations, it is helpful to shareholders for management to explain changes to the implementation plans and how they continue to align with a company's purpose and strategic framework. Sound explanations make it more likely that investors would support management even when events result in a company missing milestones.

Our Expectations of Boards and Management Teams

We believe long-term corporate strategy, purpose, and financial resilience are important value drivers. Detailed disclosure of a company's long-term strategy is essential to shareholders' understanding of a company's direction of travel and potential to deliver sustainable financial performance. It should provide context for critical strategic, capital allocation, and operational decisions that a company may have to make to respond to near-term challenges, e.g. investments in manufacturing plants, workforce (re)training, research and development, proposed acquisitions or divestments, and plans to return capital to shareholders, among others.

Regarding financial resilience – i.e. the ability of a company to endure immediate economic shocks and long-term challenges put forward by local or global market events – BIS seeks to further understand how companies are approaching sustainability issues that could put their ability to attract capital, and our clients' investments, at risk. As Larry Fink wrote in his 2020 letter to CEOs, we believe that "greater transparency on questions of sustainability will be a persistently important component of every company's ability to attract capital. It will help investors assess which companies are serving their stakeholders effectively, reshaping the flow of capital accordingly." With sustainable investment trends accelerating, we expect companies to be able to demonstrate a comprehensive, yet flexible, approach to financial resilience.

We consider the integrity of a company's financial accounts critical to investors' ability to assess its financial resilience. As noted in our 2021 Global Principles, the accuracy of financial statements is of paramount importance to provide a true and fair picture of a company's financial condition. We expect boards to engage with management as strategy and capital plans are developed and implemented to help inform their oversight of the financial statements. The board – through audit and risk committees, or equivalent – has a responsibility to oversee the integrity of a company's financial statements, the scope of the audit, and the qualifications and independence of the external auditor.

We also expect boards to have a clear understanding of how management instils the company's purpose into day to day operations and seeks to ensure that corporate culture is experienced as intended across the workforce and key stakeholders. To this end, culture is consistently a part of our engagements with companies on strategy because we believe that how a company operates has a strong influence on what it achieves.

BIS' Engagement on Corporate Strategy, Purpose, and Financial Resilience

Shareholders rely on disclosures to help them understand and assess a specific company's performance, risks and opportunities. To this end, we ask companies to publish disclosures in line with the relevant industry-specific Sustainability Accounting Standards Board (SASB) standards. BIS believes that SASB provides a clear set of standards for reporting sustainability information across a wide range of issues, and across industries and sectors.

When engaging on long-term corporate strategy, purpose, and financial resilience, we seek to understand a company's strategic framework, the board's process for strategic review, how strategy incorporates stakeholders' needs, and how strategy evolves over time in response to changing economic, regulatory, and societal conditions. BIS will consider context when engaging and voting on long-term corporate strategy, purpose, and financial resilience. Where relevant, we inquire about the board's role in helping management assess the company's purpose and culture, which can inform corporate strategy and be a link to long-term value creation.

The topics we might cover in a discussion about corporate strategy, purpose, and financial resilience include:

- How the company's strategic framework has evolved and what has driven the evolution (e.g., changing customer needs, resources/input constraints, industry dynamics, and global mega trends)
- How the company defines "long-term" and why that time frame is most appropriate
- The measure of "value-creation" management uses as a yardstick of financial performance
- How the board oversees corporate strategy, purpose, and financial resilience, as well as management's implementation of plans and policies to support financial resilience
- The strategic milestones against which shareholders should assess performance
- Employee and/or stakeholder involvement in shaping corporate strategy, purpose (and culture), and approach to financial resilience – i.e. the feedback mechanisms for employees/stakeholders to ensure that their voices are heard by management, and incentives to hold management accountable
- How the board and management assess the compatibility of the company's strategy and purpose, and, where there is daylight between the two, how this is remedied or addressed
- How the short-term dynamics in the business and industry feed into the long-term strategy
- The short-term pressures on the company, their driving factors, how management deals with them, and how the board incentivizes management to maintain a long-term focus
- How financial resilience is defined within the context of the company's long-term strategy and capital management
- Measures to build and support ongoing financial resilience, including, where relevant, policies related to financial gearing, foreign exchange, and other financial risks as well as related hedging policies
- Responsibilities and composition of the audit and risk committee, with independent directors having financial expertise and any issues to note in audit matters reported by the external auditors

Conclusion

BIS believes that companies focused on their purpose, with a credible strategy to deliver for all their stakeholders, will be well-positioned to endure economic shocks, and create sustainable, long-term value for our clients. A strategy should be informed by a company's purpose and be aligned with key stakeholders' interests. We look to boards of directors to oversee management's long-term strategic goals and capital allocation decisions. In our company engagements, BIS will seek clarification when we have concerns about sustainability factors that may affect long-term performance, and in turn, our clients' long-term economic interests.

Endnotes

1. Larry Fink's "2021 letter to CEOs."
2. In "A Guide to Building a More Resilient Business" Martin Reeves and Kevin Whitaker explain that "resilience is a property of systems," meaning that an individual company's resilience means little if its supply and customer base, or the social systems upon which it depends, are disrupted. Reeves and Whitaker consider companies should take a "collaborative, systems view" as one of six key actions to build resilience. According to the authors, resilience "requires systems thinking and systemic solutions, which in turn depend on collaboration among employees, customers, and other stakeholders."
3. In our more than 1,000 engagements on corporate strategy and 400 engagements on the impact of COVID-19, BIS found many companies to be fundamentally re-examining their social and economic contract with their stakeholders, placing them at the heart of their recovery strategy. See "BlackRock Investment Stewardship's 2020 Annual Report" to learn more.
4. In his 2020 letter to CEOs, Larry Fink described how markets could spark a fundamental reallocation of capital, as they started to price climate risk into the value of securities. In his 2021 letter, Larry observes how this trend accelerated even faster than anticipated. Conventional wisdom was the crisis would divert attention from climate. Instead, 2020 demonstrated that the "long but rapidly accelerating transition" to sustainable assets is only beginning.
5. From January 1, 2020 to September 30, 2020, $203 billion flowed into ESG funds. The global pandemic has in some ways supercharged this shift. According to BlackRock's 2020 Global Sustainable Investing Survey, investors who had already embarked on the sustainability journey indicated no change in their approach as a result of the p andemic; 20% said it would accelerate their plans – pointing to a greater awareness that sustainable companies can be more resilient to shocks. On ly 3% of respondents said their sustainable investing plans would be delayed as a result of COVID-19.
6. In August 2019, the Business Roundtable (BRT) published an updated Statement on the Purpose of a Corporation. 181 CEOs signed the Statement and committed to leading their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders.
7. 66% of respondents to the 2021 Edelman Trust Barometer survey agree that CEOs should take the lead on change rather than waiting for government to impose it; 65% agree that CEOs should hold themselves accountable to the public and not just to the board of directors or stockholders. United Nations Environment Programme, "Marine litter and the challenge of sustainable consumption and production" 15 July 2020.

Want to know more?

blackrock.com/stewardship | contactstewardship@blackrock.com

BlackRock.