January 21, 2022

Investor Priorities in 2022: Stakeholder Capitalism, Net Zero Transition, Human Capital Management and Long-Term Value Creation

Last year, major investors took unprecedented steps through engagement efforts and proxy voting to demonstrate their commitment to addressing the climate transition and board and workforce diversity and inclusion, with focus given to disclosure and reporting of key ESG metrics and how the board, including board committees, oversees these issues. This year, major investors have indicated that they plan to revisit the same issues, but with focus on strategy, innovation and harnessing stakeholder capitalism to guide long-term value creation.

While still keen on companies to decarbonize, investors have highlighted the need to address supply-side risks (as evidenced by current energy shortages), undertake a just energy transition, and prevent the mere reshuffling of "brown" assets from public to private entities. In his letter to CEOs published this week, BlackRock CEO Larry Fink recognized that the net zero transition will require the economy to "pass through shades of brown to shades of green", but warned that companies that fail to adapt will "go the way of the dodo." State Street CEO Cyrus Taraporevala noted in his letter to directors published earlier this month that the changes to the economy present "opportunities for companies to mitigate downside risk, innovate, and differentiate themselves from competitors."

Heading into the 2022 proxy season, we summarize below some key takeaways from BlackRock and State Street's recent CEO letters:

Stakeholder capitalism will help companies navigate the new economy. This year, Larry Fink doubled down on the need for companies to engage with their key stakeholders: shareholders, employees, customers, suppliers and local communities. Fink emphasized that stakeholder capitalism is not "'woke'" but is "*capitalism*, driven by mutually beneficial relationships between [the company] and the employees, customers, suppliers, and communities [it] relies on to prosper." Fink noted that companies that engage with their stakeholders will find it easier to innovate and adapt to changes in the economy that have been accelerated by the pandemic. Moreover, as we have previously noted, having a clear corporate purpose will help companies connect with their stakeholders and determine their stance on societal issues that affect their business (and which may require companies to speak out). Corporate purpose, Fink argued, should be the "north star" for companies navigating the current social and political tumult.

Decarbonization, not divestment, should be the primary solution for "brown" assets. Both BlackRock and State Street have cautioned against divestment strategies that result in "brown" assets being transferred to the private markets rather than being taken out of the global energy supply. In the near term, both BlackRock and State Street have conceded that the world will still need to rely on, and invest in, cleaner fossil fuels in order to ensure a just transition that recognizes the need to provide affordable energy in parts of the world where clean energy remains costly.

The net zero transition will not be uniform, and companies will need to disclose their own transition plans, targets and progress. BlackRock and State Street are cognizant that the clean energy transition will happen at different speeds for different companies and not overnight. In the meantime, companies will be expected to disclose their transition plans, including issuing reports consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and outlining short-, medium-, and long-term GHG (greenhouse gas) reduction targets to help investors understand their ability to adapt for the future. Such plans, however, need not be complete: as State Street's CEO Cyrus Taraporevala notes, "what we are seeking from these transition plans is not purity, but pragmatic clarity around how and why a particular transition plan helps a company make meaningful progress towards the destination."

The green race will reward leaders, not followers. The disruptive impact of the green transition has been augmented by the unprecedented amounts of capital being funneled into ESG-oriented investments. In his latest letter, Fink cited the rise of Tesla as one example of the rapid disruptive force of new, sustainable technology. Fink called on incumbents to consider whether they are leveraging their advantage in capital, market knowledge, and technical expertise to stay ahead of the disruptors. Capital, Fink noted, will flow to companies that continue to evolve.

The workplace has changed and companies will need to adapt. The Great Resignation has exposed some fundamental shifts in the labor market to which companies must learn to adapt. According to Fink, "employees across the globe are looking for more from their employer – including more flexibility and more meaningful work" and companies need to be responsive to the changing values and demographics of their workforce. Employers will need to face issues such as employee mental health and wellness, racial equity and childcare head on if they are to remain competitive in the labor market.

Boards will be at the forefront of the transition to the new economy. The role of boards has become ever more expansive and challenging, with investors expecting boards to oversee ESG issues alongside traditional strategic and financial matters. In particular, State Street expects boards to understand "their companies' pathway to net-zero, and how they will leverage their unique strengths and opportunities" and to oversee their companies' human capital management and DEI efforts beyond the board.

Proxy voting power will be increasingly open to shareholders. Moving forward, BlackRock will seek to provide each of its investors the ability to participate in the proxy voting process. BlackRock has also called on asset managers that invest in its funds to grant their clients the opportunity to participate in the proxy voting process. The shift is geared toward providing clients the choice to vote more directly, and BlackRock will retain its stewardship teams and continue to execute votes at the request of its clients.

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The recent letters from BlackRock and State Street's CEOs underscore how the burden has now shifted to companies to demonstrate that they are future proofing their businesses for the oncoming disruptive changes to the economy. Both BlackRock and State Street have indicated that they recognize that the transition to a greener economy will be a bumpy one and both will be keeping score on each company's progress—or as Fink puts it, whether a company is navigating the transition from dodo to phoenix.

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