

Pandemic scrutiny brings purpose to the fore

During the pandemic, companies have come under greater pressure to demonstrate their value to society while treating their employees, customers and suppliers well. This has reinvigorated the debate about business purpose. Amy Wilson outlines why this matters, and how we engage with companies to help them articulate and remain true to a clear business purpose.

Setting the scene

Government support for companies during the Covid-19 pandemic has demonstrated why all businesses need to maintain a social licence to operate underpinned by a corporate purpose. We have long argued in our Responsible Ownership Principles¹ and our Corporate Governance Principles² - in which we communicate our expectations to companies each year - that companies should clearly articulate their purpose and how they contribute to sustainable returns for their shareholders, stakeholders and wider society. The last few months have provided a stress test of corporate purposes and their usefulness in times of crises. A clear and meaningful business purpose should help companies to identify the right things to do in the short term, in order to fulfil their purpose over the long term.

For further information, please contact:



Amy Wilson
Sector lead: Retail
amy.wilson@hermes-investment.com

As the concept of business purpose proliferates, there is a risk of 'purpose washing', particularly as stakeholder capitalism gains traction and more investors recognise the importance of ESG factors.

To date, many companies have disclosed only superficial or meaningless purpose statements, and few have consciously thrived because of their purpose. Likewise, the commitment by CEO members of The Business Roundtable in the US to run companies for the benefit of all stakeholders has failed to produce much meaningful change, one year on. This lack of progress does not invalidate the importance of purpose but highlights the need for investors and other stakeholders to hold companies to account.

The pandemic has added a practical dimension to the debate about business purpose, posing real-world dilemmas. While some companies have won plaudits for their compassionate and responsible behaviour, others have been widely criticised for their treatment of workers and customers. This might include pushing employees to work in unsafe conditions, delaying or avoiding paying refunds to customers or suppliers, or price gouging on sought-after items. During a crisis, companies must make difficult trade-offs between achieving shorter-term financial returns and maintaining

¹ <https://www.hermes-investment.com/wp-content/uploads/2018/10/final-responsible-ownership-principles-2018.pdf>

² <https://www.hermes-investment.com/stewardship/eos-library/>

strong relationships with key stakeholders. If a company can demonstrate it remained true to its purpose through a crisis, this will enhance its licence to operate and support long-term sustainable returns.

What is business purpose?

Purpose articulates *why* an organisation exists, what and whose problems it aims to solve, and why the organisation is well-placed to do this.

Purpose should be enduring – extending beyond the tenure of particular executives or strategies. It should be owned by the board, who act as stewards of the purpose and empower executives to enact strategies in pursuit of the organisation's purpose.

Purpose should be the most important organising principle for an organisation, informing and guiding strategic decisions, activities and capital allocation. This is the concept of 'Purpose as strategy', rather than the more commonly understood, 'Purpose as culture',³ although purpose plays an important role in culture, and cultural behaviours should align with the desired purpose.

Purpose is also distinct from vision (the strategic aim, the outcome the organisation wants to achieve), mission (what the organisation does) and values (how the organisation will operate).

The four board responsibilities



Source: Enacting Purpose Initiative

Critical interdependence

The pandemic has highlighted the critical interdependence of different elements of society, including businesses, governments, employees, customers and supply chains.

We believe this interdependence will only grow over time as society faces even bigger challenges, such as striving for racial equity as demographics shift, dealing with job losses due to automation and other forms of technological disruption, and responding to the inevitable impacts of climate change.

The economic fallout of the pandemic is already leading to record rises in unemployment and government debt, which will need to be stabilised at manageable levels. Business has been the direct beneficiary of much government spending, for example through furlough schemes, grants, government guaranteed loans, deferred tax payments and reduced interest rates.

We anticipate that governments and regulators will face pressure from the public to ensure that businesses that benefitted from government support contribute more responsibly to society. In particular we expect intense scrutiny of tax arrangements and bailout conditions, employment law and worker health and safety, and executive pay against a backdrop of high unemployment and inequality. With governments demonstrating that they are prepared to act swiftly to address the pandemic, companies need to be better prepared for future crises and for sweeping changes to the way they can operate.

Now is the time for companies to review their corporate purpose and its relevance for the business. This should clearly articulate a positive contribution to society, identify the stakeholders most critical to sustainable returns, and how the company's strategy and risk management processes can deliver value to all stakeholders.

The pandemic has highlighted the critical interdependence of different elements of society, including businesses, governments, employees, customers and supply chains.

Our expectations

We expect companies to be guided by a purpose that serves not only shareholders, but also other stakeholders, society and the environment. This helps to protect the long-term interests of savers and pensioners – both current and future – invested in companies, who require sustainable financial returns and an economy, society and environment capable of providing a secure future.

In our engagements, we consider how purpose is expressed, supported by our Statement of Purpose guidance⁴ on producing precise statements of purpose that identify important stakeholders and clarify ownership by the board. We also consider how purpose is enacted, seeking clarity on how the current strategy and capital allocation are aligned with purpose, and how it is embedded into organisational behaviours.

Our work with the Enacting Purpose Initiative (EPI)⁵ aims to support this. The initiative, which we co-lead, along with Oxford Said Business School, University of California Berkeley Law School and others, brings together academic research with insights from company lead directors and executives to provide practical guidance for boards on embedding purpose in organisations. The EPI's first report provides a European perspective, and a US-focused report will follow.

We intend to use the outputs of this work to deepen our discussions with companies on how they can practically enact purpose and move beyond high-level statements and alignment with culture, to embed corporate and societal sustainability in their strategy and capital allocation.

³The Enacting Purpose EU report expands on this distinction <https://www.enactingpurpose.org/assets/enacting-purpose-initiative---eu-report-august-2020.pdf>

⁴<https://www.hermes-investment.com/ukw/wp-content/uploads/2019/08/statement-of-purpose-guidance-document-aug-2019.pdf>

⁵<http://enactingpurpose.org/>

Our company engagements



Engie

French electric utility company Engie is in the process of defining its purpose. The company invited us to participate in a survey, through a consultant, gathering the views of stakeholders on this topic. We presented our guidance on preparing a statement of purpose and highlighted the importance of identifying the most relevant stakeholders.



Travelers

In response to our engagement, this US insurance company included a statement from its lead independent director in its sustainability report outlining its purpose, important stakeholders and the role of the board and management. We are encouraging improvements to the expression of purpose and its elevation from sustainability to annual or proxy reporting.



Persimmon

We are engaging with UK housebuilder Persimmon on improvements to its culture and operations to better align with its stated purpose after controversies on executive remuneration and poor quality.⁶ Its purpose is to build good quality homes at a range of price points across the UK. It aims to “create and protect superior and sustainable levels of value for the benefit of our customers, workforce, suppliers and shareholders through the housing cycle”.



BP

In response to intense engagement by EOS and investors as part of the Climate Action 100+ collaborative initiative, including filing a shareholder resolution in 2019, the oil and gas major has restated its business purpose: “Our purpose is reimagining energy for people and the planet. We want to help the world reach net-zero and improve people’s lives.” This is supported by 10 long-term aims and various short and medium-term targets. Our engagement is now turning to implementation.



Centrica

As a result of engagement at UK utility Centrica, the company has set an objective to decarbonise the greenhouse gas emissions of its customers. It has also updated its business purpose to include clear reference to the need to support the low carbon transition, saying: “We are an energy services and solutions company, focused on satisfying the changing needs of our customers and enabling the transition to a lower carbon future.”

We have continued to discuss the idea of creating a statement of purpose with various other companies including Morgan Stanley, CVS Health Corp, Bristol Myers Squibb, Bank of America and Baidu.



We are engaging with UK housebuilder Persimmon on improvements to its culture and operations to better align with its stated purpose after controversies on executive remuneration and poor quality.

Outlook

With many companies around the globe badly affected by the pandemic, business purpose has acquired a greater relevance across many different sectors and geographies. We will look at how well a company’s corporate purpose guided and informed their actions through the crisis, and how well prepared they are for the future.

Questions we will ask include:

- How have the trade-offs between different stakeholder groups, such as investors, the workforce, suppliers and customers, helped to preserve the company’s licence to operate?
- Should the corporate purpose be reviewed or clarified and how will it inform the development of the business, including:

- The link to strategy, including long-term goals and metrics of success to demonstrate achievement of positive societal outcomes and capital allocation decisions to support this. This may include the balance between short- and long-term investor returns, balance sheet resilience, and the need to prepare for long-term changes in business models, such as achieving net-zero emissions by 2050

- Relationships with key stakeholders including how best to set the culture and employee proposition to improve loyalty and productivity while addressing important societal concerns, such as racial equality and giving different stakeholders a voice through representation and/or enhanced communications.

⁶<https://www.standard.co.uk/business/persimmon-probe-slams-systemic-poor-culture-and-demands-change-a4315691.html>

Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

For more information, visit www.hermes-investment.com or connect with us on social media:



For professional investors only. This is a marketing communication. Hermes Equity Ownership Services (“EOS”) does not carry out any regulated activities. This document is for information purposes only. It pays no regard to any specific investment objectives, financial situation or particular needs of any specific recipient. EOS and Hermes Stewardship North America Inc. (“HSNA”) do not provide investment advice and no action should be taken or omitted to be taken in reliance upon information in this document. Any opinions expressed may change. This document may include a list of clients. Please note that inclusion on this list should not be construed as an endorsement of EOS’ or HSNA’s services. EOS has its registered office at Sixth Floor, 150 Cheapside, London EC2V 6ET. HSNA’s principal office is at 1001 Liberty Avenue, Pittsburgh, PA 15222-3779. Telephone calls will be recorded for training and monitoring purposes. EOS000723 00009612 09/20