

Client Alert

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Environmental, Social and Governance (ESG) and Impact Enter the Board Room

Recently, Larry Fink, the CEO of BlackRock, the world's largest asset manager, took a noteworthy step in an [open letter](#) he wrote to the CEO's of all publicly traded companies. In the letter, Mr. Fink indicated that going forward, BlackRock intends to be asking some "hard questions" about the companies' plans to integrate environmental, social and governance factors (ESG) and Impact principles into their long term strategy and management. These questions are being directed to C-Suite and Board level executives at these public companies.

What is ESG?

BlackRock [defines](#) ESG investing as the incorporation of environmental, social and governance factors directly into the financial analysis of a potential investment to evaluate risks and opportunities. BlackRock's intention is to consider whether ESG factors contribute to or detract from the financial value of a given investment opportunity (and not to simply apply a social value screen to a given investment decision).

What is Impact?

In its simplest form, Impact is the intentional integration of the twin goals of generating a financial return and addressing an endemic social issue into the core of a company's business. When it's done right (using rigorous management practices), Impact can, for example, form the basis of a successful investment fund, the impetus for a new revenue-generating initiative within a large enterprise and even guide the long term trajectory of a company.

Why is this fundamental shift?

It is clear from Mr. Fink's letter that BlackRock's willingness to invest in businesses in the future will be materially influenced by the successful incorporation of ESG and Impact principles into the very DNA of these enterprises. This is not simply about corporate social

responsibility or philanthropy. Rather, Mr. Fink's statement articulates an approach to evaluating a business's long term viability that includes an examination of ESG factors and Impact principles. This is a fundamental shift in how investment-worthiness is being evaluated and it is likely that other leading asset managers will follow suit. Companies that are currently publicly traded or that have plans to issue an IPO in the near future should take note.

Here is a highlight from Mr. Fink's letter underscoring BlackRock's view that ESG and Impact principles are indispensable to long term financial performance and potential for growth:

The statement of long-term strategy is essential to understanding a company's actions and policies, its preparation for potential challenges, and the context of its shorter-term decisions. Your company's strategy must articulate a path to achieve financial performance. To sustain that performance, however, you must also understand the societal impact of your business as well as the ways that broad, structural trends – from slow wage growth to rising automation to climate change – affect your potential for growth. *[Emphasis added.]*

To further emphasize BlackRock's commitment to this approach, this past week, BlackRock began releasing specific questions it will ask senior management and board members about these strategies and management tactics. These questions are consistent with BlackRock's Investment Stewardship engagement priorities. The full set of priorities can be found [here](#). The first set of questions BlackRock released, concerning Human Capital, can be found [here](#).

This approach by BlackRock continues Mr. Fink's emphasis on the importance of long term strategy as a key driver of corporate financial performance. And, it

explicitly links ESG/Impact factors to companies' positive long term performance and potential for growth.

How will this affect your company?

As a start, public companies (and those intending to go public) can expect to be asked specific questions by existing and prospective asset managers that are similar to those linked above. These questions will cover a broad range of categories, including human capital management, environmental responsibility, sustainability and risk, and board engagement on the companies' long term strategy. The quality of a company's responses to these questions will be incorporated into the overall investment assessment by the asset manager and may materially affect its ongoing investment decisions and recommendations.

What are tactics you can use to begin preparing for (and possibly benefiting from) this change?

1. Read in detail what BlackRock has said on this topic – including Mr. Fink's letter and the associated questions linked above.
2. Appoint a board member to work in concert with a diverse team at your company to lead an initiative specifically targeted at incorporating ESG/Impact principles into your company's core business operations.
3. Initiate a consistent and replicable process to (1) evaluate what your company is already doing to address ESG and Impact principles; and (2) assess the opportunities and risks that would be presented by an ESG/Impact evaluation of your company. For example, if your company is in the manufacturing space, and an ESG/Impact evaluation would reveal that a significant quantity of your raw material base ends up in a land fill, this circumstance may present as both an environmental risk and an opportunity to reimagine your supply chain or product mix in a way that generates future revenue and reduces environmental impact.

The Key Takeaway:

Companies that start working now to integrate ESG and Impact principles into their core business operations will get ahead of the tidal wave triggered by Mr. Fink's letter and will achieve greater competitive advantage for doing so. We know this to be true

because the world's largest asset manager is saying so. Viewed from a different lens, these actions are virtually "quasi-regulatory" in nature since BlackRock's assets under management (at \$6.2 Trillion) are larger than the GDP of many nations. In fact, if BlackRock were a country and its assets under management were the country's GDP, BlackRock would be third largest economy on the planet. And that's a trading partner that is too large to be ignored.

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