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CORPORATE GOVERNANCE

Creating and Preserving Long-Term Value Through Global Stewardship

By Carl Hess

For modern capitalist economies to thrive, businesses must grow, sustain profits, and create value over multiple economic cycles amid volatility and uncertainty. For businesses to thrive, they require stewardship—the careful and responsible management of assets, liabilities, intangibles, and equity. Good corporate stewards preserve, protect, and increase value over time.

Today, many large institutional investors are increasingly pressuring boards and management teams to be more effective long-term stewards of the enterprises entrusted to them and more responsive to the constituents they serve. Some of this pressure has led to debates about the efficacy and wisdom of environmental, social, and governance (ESG)-based investing, management, and oversight. While these debates are important, they focus on a limited range of topics within the broader context of stewardship.

Leaders and boards of successful organizations are responsible for a much broader range of issues, including strategic direction and long-term performance, management and protection of resources, adherence to mission, purpose and values, and the overall impact of the organization on all stakeholders.

Various groups have highlighted the importance of purpose, people, and planet priorities to sustainable business operations. We believe these factors are essential but incomplete. Performance and protection priorities also are required to fully capture the business fundamentals needed for long-term resilience, viability, and growth. In fact, we'd argue that performance and protection come first and are essential for an organization to fulfill its purpose and serve multiple stakeholders.

A NEW STEWARDSHIP MODEL

We propose a new stewardship model for company governance and leadership. Pragmatic, practical, and business-minded, it is based on the belief that companies must create sustainable long-term value and be responsible members of a global economy that also sustains value long term. This fundamental tenet establishes a standard by which to evaluate decisions and trade-offs, allocate resources, make long-term plans, and evaluate progress. It is not a simple framework, but we believe it can lead to win-win solutions grounded in practical business fundamentals.

Stewardship is the overarching principle that incorporates five key elements: performance, protection, people, planet, and purpose.

Performance. Strong, consistent, and sustainable financial performance and value creation are essential for an organization to responsibly serve all stakeholders and pursue a broader purpose. Given the legal structure in which companies, particularly those that are publicly traded, operate, organizations must satisfy ownership interests to remain viable. Those that fail to fulfill such interests do so at their own peril and at the peril of other stakeholders.

We put performance first not because it supersedes or dominates other elements of stewardship but because all the other elements in turn drive performance:

- **Protection:** Effective risk management and mitigation are essential to maintaining and protecting long-term value and safeguarding organizational viability and sustainability for the long term.
- **People:** Highly engaged, healthy, safe, motivated, purpose-driven people perform better, are more creative and innovative, and drive greater financial results and value creation.
- **Planet:** Quantifying, assessing, and actively managing the significant risks and opportunities from climate change and other environmental challenges is and will be essential to long-term corporate sustainability and value creation.
- **Purpose:** Companies with a coherent, clearly understood, and authentic purpose tend to significantly and consistently outperform their peers.

Protection. Boards in virtually every industry are now more attuned to risk and have higher expectations for effective risk management. Over the last several years we have seen multiple low-frequency, high-impact events arising almost simultaneously: cyberattacks, a global pandemic, financial shocks, spiking inflation, a series of "hundred-year" weather events, social and political disruptions, supply-chain imbalances, and significant labor shortages. While the frequency and concurrence may appear unlikely, WTW predictive analysis suggests a high probability of one or more of these low-likelihood events in any given decade, with an even higher likelihood of multiple occurrences when they are interdependent.

Enterprise risk management is now almost as important as performance to the long-term sustainability of most organizations. Good stewards effectively manage such risks by viewing them through a common lens at the enterprise level. By considering a portfolio of risks cohesively, companies can achieve better outcomes than by managing them independently. Advanced analytics and statistical models addressing connected vulnerabilities lead to improved

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foresight and judgment and help organizations avoid a downward performance spiral created by multiple interrelated factors.

Managing risk means constantly identifying and anticipating threats, preparing for the unexpected, and being ready to act decisively when needed. Many severe risks are underquantified, underinsured, and not well understood, including climate, geopolitical, terrorism, cyber, food and water insecurity, supply chain, talent, and reputational risks. Unmitigated, they leave organizations open to potentially irreversible damage to crucial assets (including people) and systems, and severe reductions in share valuation.

The market's perception of a company's overall risk will be reflected in the volatility of its stock price and cost of capital. Effective risk management should result in higher and more consistent return to shareholders and a more sustainable business over the long term. Boards and senior leaders need to have a thorough understanding of their portfolio of risks, how they relate to each other, and the most cost-efficient means of mitigating and transferring them.

People. A healthy, diverse, skilled, and engaged workforce is essential for long-term business viability and success and is therefore a key element of stewardship. Effective stewardship requires at least as much focus on people as has historically been placed on physical assets, products, and brands.

Recognizing this importance of people, board members have expanded their oversight over human capital. Board and committee agendas have broadened to include regular deep dives into the engagement, diversity, skill sets, and wellbeing of a company's workforce at all levels. Some of this is due to investor pressure, but much of it reflects board members' appreciation of the essential role of people in driving performance and creating long-term value. And much of it is data driven, as studies by WTW and others demonstrate the strong connection between company performance and measures of employee engagement, employee experience, diversity, equity, and wellbeing. In fact, companies that score high on key human capital metrics consistently outperform their peers on financial and stock measures.

Vigilant oversight of human capital requires increasingly sophisticated and meaningful data and metrics. Basic measures include demographics, cost, turnover, productivity, and diversity, which are viewed and analyzed at multiple levels of detail. More sophisticated measures analyze the quality and condition of people assets: employee experience and engagement, pay and benefit equity, opportunity for career and pay advancement, key skill levels and gaps, dimensions of wellbeing, and succession planning.

Planet. Climate change and the transition to a net-zero economy pose new challenges for leaders as the frequency and concurrence of climate events increase and the demands for climate transition goals grow. Stewards act to understand and quantify their organizations' environmental impact as well as to address the multidimensional and multitemporal aspects of climate risks in their strategies. Examples include physical and liability risks to people and property arising from extreme weather events, biodiversity challenges, and transition risks emerging from the impact of changing strategies and operations during the move to a low-carbon economy. Leaders must understand the impact of these risks to people, operations, financing, capital allocation, and enterprise value and take steps to mitigate them.

Climate analytics enable leaders to make robust decisions by enhancing transparency and reducing data gaps. Because people are critical enablers of both sustainability and risk management efforts, stewards focus on people-oriented interventions to help achieve climate goals.

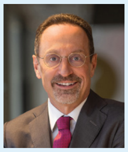
Successful organizations create a culture bolstered by programs for employees to support company commitments around climate change. They tackle climate risks through adaptability, incorporate information as it becomes available, and act decisively when sudden events happen, all while managing long-term strategies to achieve climate transition goals.

Purpose. As investors and boards increasingly emphasize intrinsic value and long-term economic health, they understand that purpose and profit are interdependent. Being purpose-driven does not mean abandoning business principles for social issues. Rather, it acknowledges that corporations generate profits and long-term value by creating benefits to society, developing new vaccines and drugs, distributing essential goods, providing capital, providing nourishment, and powering cities. Organizational purpose drives constancy in company culture even while markets, business models, and daily operations transform.

Purpose-driven action helps connect employees' and customers' values to those of organizations. It includes creating cultures, programs, and experiences that help employees achieve their health, wealth, and career priorities. Acting with purpose also includes articulating and delivering on ESG commitments and mitigating their risks.

LOOKING AHEAD

Global stewardship supports the essence of capitalism, with leadership actions focused on both short- and long-term value creation, viability, stability, financial performance, and growth. Protection and performance are essential components to add to purpose, planet, and people for organizations to thrive today and tomorrow.



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