Stakeholder Capitalism – Embracing Today's Opportunity

The first article on resilience and sustainability discussed how a commitment to the environment, society and governance (ESG) factors is not at odds with profitability, and, if executed successfully, will lead to superior near-term revenue. Evidence is convincing that a credible ESG commitment results in higher employee engagement, increased productivity, creativity and courage; all of which are directly linked to higher profitability. Customers evaluate a company based on where it stands on matters of principle, such as the environment, social justice, and inclusive corporate governance. By establishing shared values with customers, the company earns improved brand loyalty and trust, both of which drive increased top line growth. In addition to developing long-standing, trusted customer relationships, a commitment to ESG can result in other drivers of profitability such as improved social contracts with employees, direct cost reductions, more effective regulatory and dialogues, and better use of capital. All in all, ESG is good business.

Insurance companies have begun to recognize the importance of ESG and are relying on its framework and reporting metrics to adopt a mindset focused on stakeholder capitalism. While industry leaders are at various stages, a corporate culture focused on balancing the needs of all stakeholders is evolving with strategy and operations being set accordingly. ESG metrics are rapidly becoming the basis for benchmarking and tracking progress. Some business executives are advocating that a commitment to ESG is not only a responsibility but a driver of tectonic change in the industry. Representing the investment community, Larry Fink, Chairman and Chief Executive Officer of BlackRock Inc., acknowledged the significance of sizeable capital flows into sustainability funds and the profound effects this will have on passive investing which typically do not prioritize companies focused on ESG. He noted that as investors allocate their monies into companies focused on sustainability, "the tectonic shift we are seeing will accelerate further. More and more people understand that climate risk is investment risk." Furthermore, in the rousing words of Mario Greco, Chief Executive Officer of Zurich Insurance group, Ltd., he emphasized that society is experiencing transformational change and business leaders must take action. "Change is happening beyond the insurance sector. Society itself is transforming." Mario references the forces of globalization, the mobility of talent and funds, shifting geopolitics, reskilling for a digital workforce, demographics, and climate change as examples of monumental changes. He states with conviction that "We can no longer expect the responsibility to fall on our political leaders alone. As business leaders, we must step up and take actions – individually and collectively – to be agents of change and play a more impactful role in addressing these societal issues. This is a key driver of customer trust in our transforming world."

The ultimate proof of the value of a firm's commitment to ESG factors, even referred to as the "holy grail," is when we have convincing evidence that ESG scores are a determinant of a firm's cost of capital. If it is true that a company's dedication to ESG results in higher revenue, then it follows that lower capital costs will result in higher corporate valuations. McKinsey & Company recently reported "Evidence is emerging that a better ESG score translates to about a 10 percent lower cost of capital, as the risks that affect your business are reduced." Nevertheless, they duly note that this evidence falls

short of indicting causation and contrary evidence does exist as well. Without precise and consistent metrics to support ESG scores, it is uncertain to know whether firms that, for example, engage in environmental neglect are charged a higher cost of capital. On the other hand, as noted in the McKinsey report, it is certainly plausible and may be a signal that we are in the early stages of a radical market shift as capital flows favor companies who not only commit to ESG but who also direct business towards equally committed participants in their supply chain.

So how should firms take the leap? Begin by reevaluating your firm's mission statement and ensuring that it is truly reflective of purpose - how the firm plans on making its mark in the world and how purpose will drive decisions, strengthen relationships, and ultimately steer to company towards financial success. This is not a notional exercise. It is deeply personal to the company and its leaders, requiring stakeholder involvement and buy in. Once purpose is defined, the firm should conduct a firmwide assessment of current ESG efforts because these early efforts can inform a more robust and integrated purpose-driven strategy. For example, when Mark Pearson, President and Chief Executive Officer of Equitable Holdings, Inc., conducted such an inventory, he identified a highly effective program addressing the economic and societal problems associated with under-saving for retirement. Equitable joined the Alliance for Lifetime Income as a founding member and, together with 24 leading financial services organizations, set out to help Americans address the risk of outliving their income so they can lead a dignified life after retiring. This led to the recognition that the repayment of the $1.5 trillion dollars of student loan debt in the U.S. was a significant deterrent to saving for retirement in the early years when the compounding impact of saving is most pronounced. Equitable also uncovered that individuals working for public schools, non-profits, military, and government entities, may be eligible for one or more loan forgiveness programs that can help lower the monthly payments, but the application process for these programs was complex, thereby deterring applicants. By partnering with StudentLoan Tech to simplify the application process for loan forgiveness, Equitable is helping individuals reduce their monthly student payment obligation and is educating them of risk associated with under-preparedness for retirement. Customers then redirect the monies from student loan repayment to retirement accounts. Equitable recognized three insights from this program that will influence their evolving ESG strategy. First, as opposed to a direct growth initiative, the program was motivated by solving the conflating effects of two burgeoning social problems (the student loan debt crisis and under-saving for retirement) resulting in their commitment to help customers experience dignity in retirement. Second, it was a collaborative effort with participants in the Alliance learning from each other while leveraging their networks; and lastly, it has tangible financial benefits for both the customer and Equitable.

This is not a race or a competition. The private sector is on the verge of a unified effort that could inure to the benefit of all stakeholders. An ESG commitment is not a tool for gaining a competitive advantage but instead a way to promote a new economy for the benefit of all stakeholders including customers, employees, suppliers, communities, shareholders, and society at large. How a company executes and ultimately capitalizes on their ESG commitment will lead to unique benefits or advantages for their firm. So, in the early stages of adoption, look around, learn from others, and perhaps join others in collaborative initiatives driving network effects at scale.

An example of two such collaborative initiatives are Generation and Verge Impact. Generation, the non-profit global employment organization, has secured $77 million in new funding and $50 million of in-kind resources from BlackRock, McKinsey, Microsoft, and Verizon, to accelerate its work in tackling unemployment across 14 countries around the world. The problem is significant and widespread. India's unemployment rate reached 24% in 2020. Spain has one of the highest youth unemployment rates in Europe, with about 40% of youth currently out of the workforce. In Italy, COVID-19 led to a 20% reduction in hours worked compared to 2019, with retail and tourism – two sectors with the highest youth employment – among the hardest hit sectors. In the U.S. it is estimated that 42% of COVID-19 related layoffs will become permanent. The impact, both in health outcomes and economic damage, is already being felt more acutely by communities of color. The joint commitment among global giants will

allow Generation to support people who face systemic barriers to employment - particularly young adults and midcareer workers - as COVID-19 continues to threaten jobs and global economic growth. What is notable is the commitment involves not only funding but in-kind access to their proven methodologies and networks.

Verge Impact is a recent program, sponsored by Milliman, designed to promote initiatives that help to overcome the barriers impeding the success of small and middle market enterprises (SMEs). In the wake of Covid-19, Yelp estimates that 800 SMEs close per day, with the majority being permanent closures. Recognizing that permanent closure among black-owned SMEs is 2.5x the rate of white-owned SMEs, Verge Impact is initially focused on understanding the barriers to success faced by black entrepreneurs and then will move to collective action to overcome these barriers. Verge Impact began by convening C-suite executives from the technology and insurance sectors. Working alongside owners of black-owned SMEs, these executives identified the wealth gap, financial acumen, and access to capital and networks as barriers to success. Now Verge Impact is seeking key partners to develop and implement a solution. While in the early stages, Verge Impact is an example of how insurance companies are collaborating with companies outside their industry to solve significant societal and economic problems and how these solutions could eventually inform their ESG strategy.

Companies are moving with intent and at record pace towards defining their purpose relative to all stakeholders using ESG as a framework and are developing strategy and operations accordingly. Firms understand that ESG is good business and are initially focused on how their commitment will drive profitability. Eventually, a firm's impact on the environment and societal well-being will determine their access to and cost of capital driving valuations. In time, firms will not only be accountable to their own ESG commitment but will hold all in their supply chain accountable as well. As those changes emerge, sustainability will become mainstream, purpose will become prosperity and the power of collective action will drive tectonic shifts. Stakeholder capitalism is no longer tomorrow's untapped opportunity, but instead is today's opportunity to influence the world we live in and establish the relevance of our companies in this new world.

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Joan is the founder and former CEO, Blue Marble Micro, Ltd. She is currently serving the industry as an Independent Director for Equitable Holdings, Inc., Ambac Financial Group, Hamilton Insurance Group, Ltd. and The Institutes, as well as on the board of Element Financial Management Corporation. She is dedicated to furthering her work in insurance by helping entrepreneurs and leaders align their commitment to Stakeholder Capitalism with drivers of financial success. Joan held a Professorship and Chair at Villanova University and Wharton, University of Pennsylvania.