Moral Money Forum

The long-term view in a short-term world
Foreword

Welcome to the first of our FT Moral Money Forum reports. Its theme flowed naturally from the circumstances in which the members of our think-tank held their first discussion: on a video call, in the middle of a historic pandemic. We wanted to focus on topics of lasting importance to a wide array of FT readers, but we were gathering at a time of almost unprecedented uncertainty about the short term.

The human and financial pressures Covid-19 has imposed mean that business and investment leaders have rarely been more aware of the potential trade-offs in trying to look beyond their next quarterly performance statement. And yet, as Sarah Murray discovered when she polled FT Moral Money readers, explored the data and interviewed leading thinkers and practitioners on this subject, there has also rarely been more momentum behind efforts to make business and investment more long-term focused.

This report focuses not just on the case for looking to a further horizon, but on the practical ways in which some long-term leaders are showing it can be done.

We hope you enjoy it.

Andrew Edgecliffe-Johnson
US Business Editor,
Financial Times
How to take the long-term view in a short-term world

There is more agreement about the damage short-termism is doing than about how to defeat it, writes Sarah Murray

Until recently, the chief claim to fame of the small French town of Florange was as the seat of Lothair II, the Saxon king of Lorraine who fell out with the Pope after he tried to leave his wife for his mistress. But in 2014 its name entered the capital markets lexicon when it appeared in legislation that requires French companies to give double voting rights to investors who hold their shares for two years or more.

The Florange law was named after the industrial community that was at the centre of a bitter row several years after the hostile €26.9bn takeover of Arcelor by Mittal Steel. The company tried to shut down the town’s two blast furnaces — until a French minister accused it of “blackmail” and “lies” and threatened nationalisation.

The incident was an early sign of unease over the short-termism that many companies, investors and policymakers say has undermined progress towards more sustainable business practices.

Seven years on, a host of other responses has emerged around the world, from the launch of the Long-Term Stock Exchange in San Francisco to the ditching of quarterly earnings reports, most famously by Paul Polman when he was chief executive of Unilever.

In this outcry against short-termism, big investors have had the loudest voices.

In 2018, the billionaire investor Warren Buffett joined Jamie Dimon of JPMorgan Chase to lament the “unhealthy focus on short-term profits” that stems from three-monthly earnings reports, most famously by Paul Polman when he was chief executive of Unilever.

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By early 2020, short-termism was being attacked by everyone from executives at Davos to environmentalists at not-for-profit groups such as the World Wide Fund for Nature.

Their frustration is unsurprising given the evidence of how bad it is for business. In 2020, for example, the CFA Institute, the association for investment management professionals, estimated the cost of short-termism to S&P 500 companies at $79bn a year in forgone earnings. Three years earlier the McKinsey Global Institute found that companies which took a long-term approach had 47 per cent stronger cumulative revenue growth, with less volatility, than other groups. Yet 70 per cent of executives surveyed by McKinsey last year believed that their CEOs would sacrifice long-term growth for short-term financial objectives.

Today the short-term approach to business and investment is also blamed for hampering ESG investing: the environmental, social and governance strategy, which, studies say, drives stronger long-term returns. Last year Morningstar found that funds with higher ESG ratings outperformed their benchmark indices more frequently than those exposed to greater ESG risk. Meanwhile, inflows into ESG investments have risen so sharply that in February 2020 the Financial Times ran an article with the headline: ‘Monstrous’ run for responsible stocks stokes fears of a bubble.

A month after that, the world was turned on its head.

With countries locking down their citizens, capital markets nosediving and dire predictions of the economic fallout, the Covid-19 pandemic had CEOs wondering if their companies would make it to the next month. In this moment of acute short-term pressure, the question many asked was whether the foundations of the longer-term, sustainable approach were about to crumble.

A short list of long-term strategies

- The rise of ESG investing is making more money managers focus on sustainable returns
- The emergence of climate-focused shareholders is adding a long-term twist on investor activism
- Moving early to anticipate far-off threats to existing business models can turn them into opportunities
- Communicating an explicit long-term plan can be critical for getting shareholders onboard
- Some companies are rethinking their governance to create separate short- and long-term roles
- Trying part of executives’ pay to sustainability targets is becoming increasingly common
- Cumulative earnings reporting could shift analysts’ obsessive focus on the next quarter’s results

Source: Morningstar
The perils of living in the moment

Sarah Williamson likens the persistence of short-termism in business and investment, despite evidence of its costs, to car dealers who offer a discount simply because the end of the year is approaching. "It is pervasive," says Williamson, CEO of Boston think tank FCLGlobal, which champions long-term investing. "People try to hit quotas and they will cut corners to do it."

Faced with the threats to profits caused by the Covid crisis, the temptation has been to cut much more than corners. Early in the pandemic, this instinct seemed to threaten what had been a growing commitment to sustainable approaches. Just months after 181 US CEOs belonging to the Business Roundtable had pledged to run their companies for the benefit of all stakeholders, including employees, several of them had to make deep cuts in headcount to weather the storm (though some cut their own salaries too).

Of course, short-termism existed long before the pandemic, and laying blame for it on any one player in capitalism’s ecosystem is tough. When we asked FT Moral Money readers whether business was too focused on the short-term, the response was an overwhelming “yes”. But there was less agreement when asked for the reasons. Respondents pointed to everything from executive compensation to an “obsession with quarterly earnings and reporting to appease shareholders”.

Matt Orsagh, a governance expert who is director of capital markets policy at the CFA Institute, encountered this phenomenon while researching Breaking the Short-Term Cycle, the institute’s 2006 report. The team asked finance professionals what drove short-termism. "We got them all round the table and fingers were pointed," he recalls. "It’s the sell side; it’s the buy side; it’s hedge funds; it’s compensation; it’s the earnings guys’ practices. We found that everyone was right in that we all played a role."

For Judy Samuelson, who founded the Aspen Institute’s business and society programme, one of the biggest culprits is the shareholder primacy mantra, which has been drilled into investors and corporate executives by business schools and the media since Milton Friedman’s 1970s heyday. "It’s the noise they’re constantly hearing," says Samuelson, author of The Six New Rules of Business: Creating Real Value in a Changing World. "This design of executive pay packages amplifies this noise, she says. She also believes that most executives want to do the best for both their company and society but their financial rewards work against this. "They are not unaffected personally by the design of pay," she observes.

Many investors agree with this. In fact, seeing executive pay tied to short-term share-price moves has become a red flag for some. "Where we tend to be less supportive of executive compensation proposals is when they are single-metric driven, only looking at share price and not considering performance more in the round," says Sandy Ross, global head of investment stewardship at BlackRock.

Myths persist that maximising shareholder value, including giving priority to short-term gains, is part of a board of directors’ fiduciary duty. "Myths persist that maximising shareholder value, including giving priority to short-term gains, is part of a board of directors’ fiduciary duty," says Colin Mayer of the Said Business School at Oxford university stresses that such falsehoods must be put to rest. "The law not only allows directors to take into account the impact of the long- as well as the short-term," he says, "but in the case of the UK, it requires directors to pursue the success of the company for the long term, as well as the short-term."

"Short-termism is so ingrained, he argues, that finding a single easy answer is tough. "Whether it is politics or finance or daily life, short-termism is something everyone struggles with."

Source: EY Long-Term Value and Corporate Governance Survey of 100 CEOs, Feb 2021

‘Myths persist that maximising shareholder value, including giving priority to short-term gains, is part of a board of directors’ fiduciary duty’
The conversation starts to shift

When wildfires swept through California last year, they not only hit big businesses of a warming planet, they hammered home the fact that being in the middle of one crisis does not exclude others. For companies exposing long-term themes, climate risks have long been part of the discussion. But the pandemic and 2020’s racial justice protests added the need to promote diversity, health and fair working conditions to the list that is driving companies towards a more strategic approach. “We’ve had a huge wake-up call that employees want something different,” says Samuelson.

One leader who welcomes the new pressures is Claus Asgaard, CFO of Mars, which with Said Business School launched the Economics of Mutuality, now an independent think-tank that helps companies to embed sustainable strategies. “The good news is it comes more and more naturally,” he says. “The data is clear in terms of what needs to get done, it is what the talent wanting to join corporations like ours wants to see and it is increasingly clear what consumers want to see.”

However, the push for companies to extend their horizons is coming not only from employees and consumers. In the investment community, money is talking. By 2050, ESG funds represented $11.6tn in assets under management in the US alone, 44 per cent above 2018’s figure of $8.1tn, according to the Forum for Responsible and Sustainable Investment.

Money managers have also turned up the heat on short-termism. In his 2021 letter to CEOs, BlackRock’s Larry Fink called for companies to demonstrate how their plans to reduce its carbon emissions. Another is Climate Action 100+, an alliance of investors with a combined $52tn in assets under management, which presses companies to cut emissions, strengthen governance and enhance climate-related financial disclosures.

Even mainstream investors that do not identify as activists now ask new questions, says Wendy Cromwell, director of 100+, an alliance of investors with a combined $52tn in assets under management, which presses companies to cut emissions, strengthen governance and enhance climate-related financial disclosures.

“Instead of questions about whether you’re going to beat or miss a quarter, you hear investors asking how has the crisis informed strategic planning or what opportunities might arise after it has passed - things that are more strategic and long-term.”

Tangible evidence of the effect of a warming climate on economies and individual companies has prompted discussion among business and investment executives about long-termism and, by extension, sustainability. FT Money readers have noticed the shift. “The evolving materiality of issues like climate change is such that leading businesses are beginning to factor these existential threat issues into action now,” observed one. “Are they doing enough? Not yet but there appears to be an increasing realisation that radical action is needed, and it is in the interest of business to lead on.”

The prospect of more climate legislation undoubtedly plays into this. China, South Korea and Japan are among those to have pledged to become carbon-neutral economies, as has the EU with its proposed European Green Deal. In the US, the Biden administration has stressed its intention to take climate action seriously, and this will include rejoining the Paris Agreement.

So while many wondered whether the pandemic would result in business and the capital markets taking their eye off the ball with respect to long-termism, a number of forces – including the Covid crisis itself – seems to be driving the opposite response. “The fact that we are in the midst of a pandemic makes us all realise there are long-term systemic issues that can have short-term impacts,” says Cromwell.

A tale of two transformations

While companies may understand the need for a longer-term approach, how should they turn that insight into action? One critical approach is to be sure to adapt in anticipation of future threats. Two proponents of this are DSM, the Dutch materials technology group, and Umicore, the Belgian materials technology group. Seeing that environmental pressure could make their businesses unsustainable in the long-term, both have moved away in recent years from commodity operations with heavy environmental footprints to become nimble enterprises focused on science, technology and innovation.

It was not an easy transition for either company. For DSM, whose name originally stood for Dutch State Mines, it meant substantial divestments and acquisitions. In 2002, DSM sold its petrochemical business. Then it acquired Roche Vitamins and Fine Chemicals, which laid the foundation for the move into nutrition.

““What was interesting was to see the reflection around where to invest the proceeds of exit and the decision to reposition the company to something that a lot of people didn’t know much about,” says Geraldine Machtett, who is DSM’s co-CEO and CFO. “The ability to see that as the next big opportunity and move into it was very courageous and daring.”

For Umicore, the move out of mining and into materials and services for clean vehicles and recycling took a leap of faith - as well as a heavy investment in technology. “What’s behind our transformation is the acknowledgment that we don’t know what’s going to happen,” says Marc Gryngen, Umicore’s CEO. “So we need to be best prepared to seize new opportunities.”

This kind of transformation also requires an ability to hold your nerve, particularly since companies are not always rewarded by investors for every step, and can be punished for the pace at which innovation translates into returns. One way this is expressed is through the longevity of holdings. While a small number of Umicore’s shareholders are in the stock for the long-term, says Gryngen, the turnover of shares is equivalent to the company changing hands in the space of less than a year. “We are rewarded constantly by shareholders with longer-term horizons,” says Gryngen, “while for a certain breed of investor, it is never fast enough.”

DSM has had to be resolute in the face of disapproval. “A lot of what we’ve done…we did despite market dynamics rather than helped by market dynamics,” says Matchett. She cites DSM’s 2010 decision to link half of its management board bonuses to environmental and social targets, which some investors said was a distraction from the pursuit of shareholder value. Matchett argues that such moves do in fact underpin value creation. “It doesn’t mean you’re going to do crazy stuff,” she says. “It just means you’re taking into account a broader set of factors, which makes you stronger for the long-term.”

Grynberg is unruffled by the fact that only a handful of Umicore stockholders share its long-term horizons. “I’ve always run the company in a relatively conservative manner from a financial point of view so we can perpetuate investment and research programmes regardless of short-term fluctuations in the economy,” he says. “That’s what it takes to counter short-term temptations.”

Converging interests: companies and their investors are working to increasingly similar timelines

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Source: FT/LGlobel
Putting words into action

Some companies have decided to be explicit in how they demonstrate their long-termism credentials to investors. In late 2020, for example, Borg Warner, a Michigan producer of automotive parts that make vehicle engines cleaner, outlined to shareholders its strategy to adapt to a low-carbon economy. It was not a traditional report on investment return or a presentation of ESG performance. The company gave the presentation a simple title: ‘The Next Decade’.

“For us it was important to convey the message to investors that we are running this company for the long-term,” says Frédéric Lissalde, the CEO. Long-termism, he says, is inseparable from ESG considerations: “It is the long-term thinking that leads to the obvious sustainability levers that we’ve had in the past but that are being formalised and streamlined.” It is one thing to create presentations but another to ensure they guide all elements of a company’s operations. The mission statement of Enron, the US energy group hit by a corruption scandal in 2001, contained words such as “integrity” and “excellence”. Even when corporate leaders are genuinely committed to long-term investments, they encounter forces that push for immediate results, despite the chance that those investments may deliver significant returns in time.

“Think about the [Covid] vaccines that have come to market so fast,” says FCLTGlobal’s Williamson. “The reason they were able to come to market quickly was because those companies had invested in this for years prior.” At Borg Warner, Lissalde attributes the ability to make long-term investments to the decentralised structure of his organisation. Leaving six presidents to worry about shorter-term priorities, he explains, means he and his strategy board can concentrate on long-term goals. “It’s like an orchestra: everyone has their part,” he says. “Some people are absolutely focused on delivering margins and cash flow so others can position the company for the future.”

Borg Warner is not alone in viewing governance and organisational structure as being key to a long-term approach that underpins sustainable growth. At Novozymes, the Danish biotech company, the board governs sustainability, while in 2020 a new corporate sustainability committee was created that reports to the executive leadership and is responsible for integrating sustainability into business and innovation strategies. Novozymes has tied one-fifth of executives’ long-term incentives to sustainability goals and many FT Moral Money readers express a hope that such pay strategies will become more common. So far, they remain the exception. A study by the Conference Board, an international think-tank, found in 2020 that just 604 companies in the Russell 3000 index tied compensation to any kind of ESG target.

The challenge is that linking remuneration to sustainability targets dictates that you have to define what is meant by success. Companies and investors can be forgiven for being perplexed by what many say is an “alphabet soup” of measurements and methodologies.

For years, remuneration committees’ yardstick of choice has been simple: quarterly earnings guidance. That has come at a cost, says Williamson. “If an executive or company says they’re going to make $1.27 to $1.30 [a share] next quarter, they feel an obligation to make that number. What you see time and again is that, if they’re not going to make it, they cut the things that are easy – usually people or R&D.”

She would like to see regulators encourage what she calls “cumulative reporting” in which each quarter would build on the next (three months, six months, nine months and then the full year), which would leave in place the transparency of regular reporting while avoiding the quarter-to-quarter comparisons that drive short-terms.

The change is subtle, she admits, “but a lot of this is about the feedback cycle to the management team”.

‘Linking remuneration to sustainability targets dictates that you have to define what is meant by success’

In assessing the state of short-termism versus long-termism, there is no shortage of criticism aimed at the former, including from those at capitalism’s coalface. One FT Moral Money reader links the effects of short-termism – cuts to jobs, wages and benefits that are justified as “rationalisation” or “efficiency” – as driving inequality.

“As a former institutional investment manager with three global investment management firms, I have worked inside this very system,” the reader writes. “No one admits this, yet it is so glaringly obvious.”

Even so – and despite pandemic pressures – cautious optimism is growing among investors and corporate leaders that longer-term philosophies are taking root. Compelling financial returns, pressure from investors and asset owners and disdain for quarterly guidance have combined to encourage long-term behaviour. Moreover, the consensus is that this is not only good for the bottom line but it also benefits people and the planet.

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What does managing for the long-term mean?

Critics claim that today’s companies and financial markets are severely out of balance and are focused on short-term quarterly results and raising their stock price via share buybacks rather than investing for long-term success.

A quick scan will generate plenty of examples to confirm that point, for example Kraft Heinz, but is this the reality?

Steve Rattner, in a 2018 article in The New York Times headlined ‘The Myth of Corporate America’s Short-Term Thinking’, noted that business investment has remained between 11 per cent and 15 per cent of gross domestic product since 1970. At the same time, corporate spending on research and development, an undertaking with a long payback, is now at its highest as a percentage of gross domestic product.

So what does managing for the long-term require? On examination, it is fundamentally about defining business’s role in society. Attitudes have turned 180 degrees from the 1970 Friedman doctrine, which held that a business’s only social responsibility is to maximise returns to shareholders.

Long-termism for investors means focusing on social impact as well as financial performance. Long-termism involves managing a company’s effect on all its stakeholders, articulating its purpose and working to address systemic issues such as climate change and inequality, which affect the health of the society on which success depends.

In his 2018 letter to CEOs, Larry Fink, of BlackRock, summed up this challenge: “We… see many governments failing to prepare for the future… As a result, society is increasingly turning to the private sector and asking that companies respond to broader societal challenges… Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how they benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate.”

Advisory Partners

The FT Moral Money Forum is supported by its advisory partners, High Meadows Institute and White & Case. They help to fund the reports.

The partners share their business perspective on the forum advisory board. They discuss topics that the forum should cover but the final decision rests with the editorial director. The reports are written by a Financial Times journalist and are editorially independent.

Our partners feature in the following pages. Each profiles their business and offers a view on how to think long-term in a world of short-term pressures. Partners’ views stand alone: they are separate from each other, the FT and the FT Moral Money Forum.

Does the public support this new role for business? Yes they do. A 2021 Edelman survey of 33,000 people in 28 countries found that 61 per cent trust businesses more than government, and business is also the only institution viewed as both ethical and competent. Sixty-eight per cent of respondents say CEOs should step in when the government does not fix social problems, and 65 per cent believe CEOs should be accountable to the public, not just to the board or stockholders.

As we see in the articles in this report, when companies take up this challenge and increase their social performance, focusing on material issues, they will increase their financial performance.

Managing for the long-term will ultimately require business to take the lead in transforming business models to support a regenerative and sustainable economic system.

Of course this is a bold challenge beyond the reach of many but we can see the beginnings of significant commitment. Doug McMillon, chair of the Business Roundtable and CEO of Walmart, the largest retailer in the US, last year committed Walmart to becoming a regenerative company.

He said: “The work ahead requires learning and commitment from each of us. We have created an astonishing moment of truth. The crises we face are not a science problem, they are a human problem. Technologies are important but the ultimate power to change the world does not reside in them alone. It relies first and foremost on reverence, respect and compassion — for us, all people and the natural environment that sustains us all. This is regeneration. And this is what I commit Walmart to.”

* High Meadows Institute’ views are separate from other advisory partners, the FT and the FT Moral Money Forum
Five points to bear in mind as the pandemic subsides

Investor focus on ESG has reached a critical moment, with recognition that a long-term strategy will be essential for any company that wants to deliver strong results over time. With ESG screening criteria and greater reporting transparency, the way that returns are measured has begun to move. This will be increasingly relevant as the pandemic subsides, when building resilience will be key.

Companies need to bear in mind five points:

Adapting to investor expectation
Investors and consumers now expect detailed reporting on ESG criteria, which range from diversity policies to an assessment of climate change impact. Investors are increasingly willing to criticise companies that fail to do this. Early identification and alignment of policies and practices to key principles — such as the UN Principles for Responsible Investment and international due-diligence expectations — will be crucial to companies that want to attract and retain investment and market trust.

Long-termism and legal obligations
Long-termism is at the heart of company legislation and guidance. In the UK, the legal duty under section 172 of the Companies Act 2006 is to promote the success of the company for the members as a whole and to have regard to certain statutory factors (including the likely consequences of any decision in the long-term and the effect of operations on the community and the environment). This embodies the concept of enlightened shareholder value and has been interpreted as long-term value creation. This will be increasingly relevant as the pandemic subsides.

Short-termism, agility and strategy
The duty to consider long-term consequences still requires short-term strategic agility. Sustainable decisions can meet the needs of the present without compromising the ability of future generations to meet their needs. In a time of rapid market change facilitated by technology and media that reward speed, companies will have a better chance of long-term survival if they can adapt quickly to challenges and take advantage of opportunities.

Contextualising strategy
When there is a difference between short-term actions and long-term strategy, companies can be open to challenge from all stakeholders, with listed companies in particular exposed to activist activity (increasingly focused on ESG). It is vital that companies engage with stakeholders to understand how short-term actions contribute to long-term strategy.

Risk evaluation and management
Sustainable growth is rooted in the longer-term view of risk identification and mitigation. Corporate liability regimes, including those of parent companies, are evolving internationally, with greater focus on de facto power and the exercise of de facto management and control. Disclosure requirements have increased in importance with the aim of creating a fairer world through better supply chain practices and ethical auditing. An early understanding of legal obligations, in the jurisdictions in which a group operates and within its sector internationally, allows companies to manage legal and reputational risk.

*White & Case’s views are separate from other advisory partners, the FT and the FT Moral Money Forum

About the FT Moral Money Forum

The FT Moral Money Forum takes key issues from the ESG debate and explores them for FT Moral Money subscribers. The forum highlights the macro and philosophical questions and explores the experiences and solutions being proposed. We apply an editorial filter to these and present the most interesting ideas and experiences. We also engage our data visual team to find the best form of presentation. The forum produces regular reports to highlight the ideas, policies and practices that are making a difference.

Find out more at moralmoneyeurope.live.ft.com

Upcoming events

Moral Money Summit: Europe Edition
Business Collective Action: Moving from Narrative to Action
April 27, 8.40am to 6pm BST
Digital conference

The Covid pandemic makes the integration between E, S and G even more important. As leaders try to balance budgets and purpose, can they prove that it is good business to be a good business? Following the success of the inaugural global summit, the Moral Money Summit: Europe Edition will advance the debate around relationships, money and how business can be done more responsibly. Will 2021 be the year that companies step up to tackle climate change and inequality? As groups look to rebuild and regenerate, it will be essential for them to incorporate sustainability into their strategy and operations.

The agenda will explore the concept of whole-system transformation, including employee care, diversity and inclusion policies, inclusive capitalism and environmentally friendly production and consumption practices.

Join business leaders and experts as they debate why now is the time for private-sector action and the mobilisation of the private finance market in the march to achieve internationally set targets.

Find out more at moralmoneyeurope.live.ft.com