ClearBridge Investments

Maximizing Shareholder Value Is Sustainable Business

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Key Takeaways

- Recent statements by a CEO group about lessening the importance of shareholders reflect a change in the *description* of the purpose of a corporation, rather than a change in the *mission*.
- Value creation by public companies is not about short-term gains at someone else's expense but about creating a sustainable business that can earn excess returns over a long period of time.
- We believe strong environmental, social and governance practices are critical to long-term value creation and we actively engage with companies to help them address these ESG issues.

Maximizing Shareholder Value Has Always Been About Good ESG Principles

Headlines from the *New York Times* and Associated Press, saying "Shareholder Value Is No Longer Everything, Top C.E.O.s Say" and "Top US CEOs Rethink the Meaning of Shareholder Value," sound flabbergasting at first. What could they possibly mean by that? How could shareholder value not mean what it always has, that a corporation has a responsibility to maximize value for equity holders, just as it has a responsibility to repay debt to bondholders? Of course, they must do so!

The articles concern the Business Roundtable's recent statement on the purpose of a corporation, which the Times characterized as "arguing that companies should no longer advance only the interests of shareholders. Instead, the group said, they must also invest in their employees, protect the environment and deal fairly and ethically with their suppliers." This makes much more sense: they do still believe in maximizing shareholder value, they're just saying it differently. For a moment it seemed that maybe they hadn't previously understood that these elements are essential components of maximizing shareholder value, but in reading the actual text of the release, it makes clear that this is a change in the *description* of the purpose of a corporation, rather than a change in the *mission*.

It is a common misperception among media commentators, investors, and even occasionally company managements and boards that maximizing shareholder value means damaging employees, the environment, and social good in order to maximize profits. But value creation is not about short-term gains at someone else's expense. It is about creating a sustainable business that can survive economic ups and downs and earn excess returns over a long period of time. A business may be able to sell customers a poor product for a short while, but eventually they will buy no more. Underpaying and overworking employees will yield turnover and reduced productivity, leading to higher costs in the long run. Cheating contractors and suppliers or reneging on debts will lead to having no partners to do business with over time. Damaging the environment or abusing the local community will create major long-term hidden liabilities that investors will count against your stock price.

That's why ClearBridge has focused on environmental, social, and governance (ESG) issues for many years. It is commonly misperceived as a feel-good approach that just wants to sell itself as sensitive to the environment and disadvantaged workers. It is not. It is fundamental to long-term value creation that a company not saddle itself with huge environmental issues that could come back to cost them a huge amount, as we are seeing now with Bayer's Monsanto division Roundup lawsuits. It is critical to assess the potential long-term costs of producing a product or service that may have negative societal effects, like tobacco or weapons or gambling. It is vital to valuation that a company have solid governance, to ensure not only that the board and management put shareholder interests over their own, but also that they make good capital allocation and strategic decisions by seeking diversity in their ranks.

This is not to say that companies with ESG problems are not investable, but that they are not doing all they can to maximize shareholder value, and thus likely trade at a cheap valuation. We seek to engage with those companies to try to convince them that their valuation can improve if they successfully address their issues. Often, we find that companies are delighted to discuss these topics and work to improve their practices, which makes investment more appealing. Other times, companies are not receptive, and we have to decide if the low valuation is low enough to qualify for investment.

So it's great to see 181 CEOs, such as JPMorgan's Jamie Dimon, signing on to a statement that shows they understand that pursuing ESG-friendly business practices is part and parcel of maximizing shareholder value. It's an enlightened view of how to achieve success for shareholders by making the business more sustainable.

About the Author

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- 19 years of investment industry experience
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- MA in Latin from the University of North Carolina at Chapel Hill
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