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Capitalising On Capitalism: The Growing Business Case For Sustainability And The Crucial Role Of Shareholders

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CAPITALISING ON CAPITALISM: THE GROWING BUSINESS CASE FOR SUSTAINABILITY AND THE CRUCIAL ROLE OF SHAREHOLDERS

Sean Douglas Tseng*

I. INTRODUCTION

Even as humanity stares down the proverbial barrel of its own environmental ruin, its response to the existential threat of climate change appears sluggish at best. With 100 companies responsible for more than 70% of worldwide greenhouse gases since 1998,¹ deliverance from environmental disaster appears heavily contingent on companies being able to significantly reduce their emissions.² However, doing so is fraught with complexity. Scholars have decried modern day capitalism as suffering from a “systemic malaise”,³ seeing the deeply entrenched norm of shareholder primacy as the key barrier to the pursuit of greater environmental sustainability by companies.⁴ Yet, recent trends call for a review of this perception.

Using a theoretical approach, I draw upon socio-legal and economic studies and reports, published mostly over the past five years, to analyse the conduct and role of shareholders with respect to climate change and sustainability within companies. Such analysis is situated primarily within the Anglo-Saxon countries, in which liberal market economies prevail and the corporate norm of shareholder capitalism is most pervasive.⁵ In doing so, I argue that, owing to a growing business case for climate action and sustainability, shareholders are, in fact, becoming a key driver within companies for such change.

In this paper, I begin by problematising the corporate norm of shareholder primacy – both in its perception as the main barrier to sustainable companies, as well as its inevitability as a feature of modern economic markets (Part II). I then explore how shareholders are nevertheless proving to play a critical role in encouraging companies to be more sustainable, thereby subverting the notion that shareholders are inimical towards such efforts (Part III). This is followed by my analysis of the reasons for these shifting trends, which include the

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¹ Paul Griffin, ‘The Carbon Majors Database – CDP Carbon Majors Report 2017’ (2017) CDP Worldwide <https://6fefcbb86e61af1b2fc4-c70d8ead6ced550b4d987d7e03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/002/327/original/Carbon-Majors-Report-2017.pdf?1501833772> accessed 16 September 2020.

² Rory Sullivan and Andy Gouldson, ‘The Governance of Corporate Responses to Climate Change: An International Comparison’ (2017) *Bus. Strat. Env.* 26, 413-425, 414.

³ Benjamin Richardson, ‘Divesting from Climate Change: The Road to Influence’ (2017) *Law & Policy* Vol 39(4), 325-348, 340.

⁴ Beate Sjøfjell, Andrew Johnston, Linn Anker-Sørensen, and David Millon, ‘Shareholder primacy: the main barrier to sustainable companies’ in Beate Sjøfjell and Benjamin Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (CUP 2015).

⁵ Suzanne Young and Stephen Gates, ‘An Introduction’ in *Institutional Investors’ Power to Change Corporate Behavior: International Perspectives* (Emerald Books 2013), 9.

growing business case for climate change and the rising influence of institutional investors (Part IV). In the last substantive Part of this paper, I acknowledge the limitations shareholder primacy poses to achieving greater sustainability within companies, and how those limitations might be overcome (Part V). Finally, I offer my concluding remarks (Part VI).

II. THE INESCAPABLE CORPORATE NORM

To explore the prevalence of shareholder primacy as the main barrier to sustainability, section A of this Part considers the rise of shareholder primacy and its impact on companies' attitudes towards environmental concerns. Section B examines how the closely related norm of short-termism more directly accounts for the difficulties companies face in dealing with climate change. Why shareholder primacy cannot be easily displaced is explained in section C, with section D demonstrating how sustainability initiatives which fail to consider its influence correspondingly fail to have any real impact.

A. The rise of shareholder primacy and the fall of the environment

Friedman's proclamation that "the only business of a business is profit" laid the philosophical foundation for shareholder primacy to take root in the 1970s.⁶ Particularly in the Anglo-Saxon world, the pursuit of profit became the fundamental objective of the corporate vehicle to the exclusion of other public or social endeavours.⁷ The growing climate of market deregulation further allowed this vision of the corporation to flourish.⁸ With more of the public owning companies through shares, the management of a company became increasingly divorced from its ownership,⁹ thus necessitating some measure of accountability between owners and management.

Accordingly, the normative purpose of company law began to coalesce around economic agency theory – a focus on "board and management accountability to shareholders".¹⁰ Without any social or higher purpose to serve, the prevailing view became that "corporations [were] to be managed for the exclusive benefit of shareholders".¹¹ Yet, growingly dispersed groups of shareholders of the modern corporation could mean equally diverse sets of interests.¹² Maximising the wealth of shareholders homogenised those interests, allowing management to work towards a common objective.¹³ Shareholder primacy hence

⁶ Tensie Whelan and Carly Fink, 'The Comprehensive Business Case for Sustainability' (*Harvard Business Review*, 21 October 2016) <<https://hbr.org/2016/10/the-comprehensive-business-case-for-sustainability>> accessed 16 September 2020.

⁷ Min Yan, 'Corporate Social Responsibility versus Shareholder Value Maximization: Through the Lens of Hard and Soft Law' (2019) *Northwestern Journal of International Law & Business* 40(1), 47-85, 54.

⁸ Benjamin Richardson and Beate Sjøfjell, 'Capitalism, the sustainability crisis, and the limitations of current business governance' in *Company Law and Sustainability: Legal Barriers and Opportunities* (CUP 2015), 9.

⁹ Simon Deakin, 'The Coming Transformation of Shareholder Value' (2015) *Corporate Governance: An International Review* 13(1), 11-18, 13.

¹⁰ Sjøfjell (n4), 83.

¹¹ Judd F Sneirson, 'The History of Shareholder Primacy, From Adam Smith through the Rise of Financialism' in Beate Sjøfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (CUP 2020), 73.

¹² Gary J Cundill, Palie Smart, and Hugh N Wilson, 'Non-Financial Shareholder Activism: A Process Model for Influencing Corporate Environmental and Social Performance' (2018) *International Journal of Management Reviews* Vol 20, 606-626, 610.

¹³ Min Yan (n7), 55.

became “a dominant social norm” recognised,¹⁴ in “its strongest form”, as synonymous with the maximisation of shareholder profit.¹⁵

Such maximisation of profit inheres within the system the drive towards economic efficiency and the attendant need to minimise costs. Indeed, shareholder primacy is seen as treating any profit-reducing activity as impermissible, lest it “impair[s] the company’s ability to achieve maximum shareholder profits”.¹⁶ What follows is a systemic impetus to externalise the environmental costs onto other stakeholders.¹⁷ Doing so avoids a negative reflection of these costs in share prices,¹⁸ which in turn promotes the market value of the company.¹⁹ By leaving unconsidered such environmental externalities, economic systems which embrace the shareholder primacy model allow “the expense of destroying the earth [to be] largely absent from the prices set in the marketplace”.²⁰ Companies therefore myopically showcase market values that fail to transparently reflect how the long-term risks of climate change impact their performance.²¹

The ostensible perniciousness of shareholder primacy is perhaps demonstrated by the contrasting picture painted by jurisdictions where it is not embraced. In particular, policymakers in Europe (apart from the UK) have greater rein over steering businesses towards more sustainable practices, with many more governmental initiatives to inculcate more socially responsible business habits seeking to protect the environment or mitigate climate change.²² Countries in which the shareholder primacy model reigns dominant, however, such as the US, have weak external governance pressures leaving little incentive for companies to take action on climate change.²³ This explains why “national governments, even the most powerful among them, face growing difficulty in controlling the activities of business, and especially finance”.²⁴

Although company law in Anglo-Saxon jurisdictions is generally reticent on managing companies’ impacts on the environment, environmental laws do exist that impose regulation on companies’ environmental performance.²⁵ Yet, this ideology of a free-reigning market has meant that environmental laws seeking to instill responsibility for environmental externalities are criticised for constraining profit,²⁶ often being replaced with “market mechanisms and voluntary regimes designed to appease business.”²⁷ Indeed, this mirrors the general tendency

¹⁴ Sjäffjell (n4), 83.

¹⁵ Virginia H Ho, “Enlightened Shareholder Value”: Corporate Governance Beyond the Shareholder-Stakeholder Divide’ (2010) *The Journal of Corporate Law* Vol 36:1, 59-112, 73.

¹⁶ *Ibid.*

¹⁷ Deakin (n9), 16.

¹⁸ Carol Liao, ‘Limits to corporate reform and alternative legal structures’ in Benjamin Richardson and Beate Sjäffjell (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (CUP 2015), 279.

¹⁹ Ho (n15), 72.

²⁰ Penelope Simons, ‘International Law’s Invisible Hand and the Future of Corporate Accountability for Violations of Human Rights’ (2012) *Journal of Human Rights and the Environment* Vol 3(1), 6.

²¹ Deakin (n9), 16.

²² Jeremy Galbreath, ‘Corporate Governance Practices that Address Climate Change: an Exploratory Study’ (2010) *Bus. Strat. Env.* 19, 335-350, 345.

²³ Sullivan (n2), 418-419.

²⁴ Susan Marks, ‘Empire’s Law’ (2003) *Indiana Journal of Global Legal Studies* Vol 10(1), 449-466, 461.

²⁵ Sjäffjell (n4), 86-87.

²⁶ Richardson (n8), 4.

²⁷ Richardson (n3), 340.

to regard issues relating to the environment as matters of ‘soft’ policy, with agreements upholding social or environmental goals as having no real consequence if breached.²⁸

Moreover, the divorced nature of ownership and management within companies militates against either side having any sense of moral ownership over their company’s environmental activities. On the one hand, casuistry – the idea that one’s moral obligations may be changed when he is responsible for deciding on behalf of another group – may compel managers to set aside personal (even environmentally friendly) preferences in favour of furthering the presumed interests of shareholders.²⁹ On the other hand, the passive ownership of companies by shareholders, uninvolved with management, weakens any moral responsibility they have over the activities of the companies,³⁰ if they bother to know about them at all.

Consequently, the recent domination of the shareholder primacy model is at once credited for the stock market’s remarkable growth while blamed for exacerbating environmental problems, rendering it difficult for firms to take a “sustainable business approach”.³¹

B. Short-term versus long-term

Closely intertwined with shareholder primacy is the corporate norm of short-termism. While properly regarded as distinct norms, shareholder primacy and short-termism are so often spoken of in the same breath that one would be forgiven for conflating them.³² Yet, it is perhaps the dissonance between the short-term perspective of the market compared with the longer-term detriment of climate change that most directly accounts for why corporate activities appear unreactive to the looming threat of the latter.³³

Short-termism is driven by the brief timeframes in which corporate performance is assessed and investment decisions are made. Financial metrics such as sales growth, return-on-equity, and price/earnings ratios provide snapshot views of a company’s performance at any given time,³⁴ enabling investors to capture short-term economic returns.³⁵ Indeed, a study has shown that global retailers expect their capital investments to generate returns within three years,³⁶ with managers’ compensation packages tied to even shorter financial

²⁸ Andrew Simms, ‘Economy: The Economic Problem of Sustainable Governance’, in Georgina Ayre and Rosalie Callway (eds), *Governance for Sustainable Development: A Foundation for the Future* (Earthscan, 2005), 77.

²⁹ Sneirson (n11), 77.

³⁰ Richardson (n8), 9.

³¹ Sneirson (n11), 73, 85; Elizabeth Schmidt, ‘Can capitalism solve capitalism’s problems?’ (*The Conversation*, 22 January 2020) <<https://theconversation.com/can-capitalism-solve-capitalisms-problems-130427>> accessed 16 September 2020.

³² See, for example, Sjäfjell (n4), 125.

³³ Lucas Kruitwagen, et al, ‘Game theory and corporate governance: conditions for effective stewardship of companies exposed to climate change risks’ (2017) *Journal of Sustainable Finance & Investment* 7:1, 14-36, 25.

³⁴ Richardson (n3), 339.

³⁵ Galbreath (n22), 345.

³⁶ Sullivan (n2), 422.

performance measures.³⁷ It is therefore no coincidence that boards, when making investment decisions, do not look beyond similar time horizons.³⁸ As Pfeifer and Sullivan state:

“The need to deliver investment performance over, at maximum, 1 year, means that investment managers are, inevitably, incentivised to focus much of their attention on short-term drivers of investment performance rather than on longer-term value drivers.”³⁹

Climate change, on the other hand, is often seen as a distant, nebulous problem, the effects of which may not even be felt in this lifetime.⁴⁰ In a world that speaks so narrowly in the language of immediate gains or losses, climate degradation can present such gradual, imperceptible change that its impact may hardly be meaningfully reflected in investment decisions.⁴¹ Where physical impacts of climate change are ascertainable, there is so much uncertainty surrounding its specific nature or timing that making any assessment of their financial impact becomes both challenging and unappealing.⁴²

The above create the conditions for what has been described as the ‘tragedy of the horizon’.⁴³ Climate change and its costs may unfold over decades, whereas corporate performance is assessed over much shorter time frames.⁴⁴ As long as risks which only “impose more immediate costs” are considered,⁴⁵ climate change will be sidelined as an unquantifiable, distant spectre that the market will treat with, at best, skepticism and, at worst, irrelevance.⁴⁶

C. A norm that is here to stay

Compounded by the short-term outlook of financial markets, it is accordingly easy to demonise shareholder primacy as the culprit for much of the inertia within the business world to undertake more socially responsible activity. This has led to a rallying cry for a new type of system to replace shareholder capitalism⁴⁷ – one that re-orientates the economy towards

³⁷ Benjamin Richardson, ‘Aligning Social Investing with Nature’s Timescales’ in Sjøfjell (n11), 570.

³⁸ Douglas G Cogan, ‘Corporate Governance and Climate Change: Making the Connection’ (*Ceres*, July 2006) <<https://www.rrojasdatabank.info/ceres06.pdf>> accessed 16 September 2020.

³⁹ Stephanie Pfeifer and Rory Sullivan, ‘Public policy, institutional investors and climate change: a UK case-study’ (2008) *Climate Change* 89:245-262, 258-259.

⁴⁰ Vinod Thomas, ‘Overview’ in *Climate Change and Natural Disasters: Transforming Economies and Policies for a Sustainable Future* (Routledge 2017), 7-10.

⁴¹ Mats Andersson, Patrick Bolton and Frédéric Samama, ‘Governance and Climate Change: A Success Story in Mobilizing Investor Support for Corporate Responses to Climate Change’ (2016) *Journal of Applied Corporate Finance* Vol 28(2), 29-33, 30; Benjamin Richardson, ‘Financial markets and socially responsible investing’ in Sjøfjell (n4), 238.

⁴² Pfeifer (n39), 258; Riyong Kim and Jaclyn Asuncion, ‘Investing in our future: Is time the potent prism for climate action?’ (2019) Mission Finance, EIT Climate-KIC <https://uki.climate-kic.org/wp-content/uploads/sites/3/2019/06/Insight_4-3_def_online2.pdf> accessed 16 September 2020, 2.

⁴³ Mark Carney, ‘Breaking the Tragedy of the Horizon – Climate Change and Financial Stability’ (Lloyd’s of London, 2015).

⁴⁴ Charles M Elson and Nicholas J Goossen, ‘Climate change and corporate board: too Hot not to handle?’ (2017) <https://www.weinberg.udel.edu/news/Documents/DBIQ17_Elson_Climate%20Competent.pdf> accessed 16 September 2020, 42.

⁴⁵ Adam Harmes, ‘The Limits of Carbon Disclosure’: Theorizing the Business Case for Investor Environmentalism’ (2011) *Global Environmental Politics* 11:2, 98-119, 104-105.

⁴⁶ Richardson (n41), 242.

⁴⁷ Mark Carney, ‘Inclusive capitalism: creating a sense of systemic’ (Conference on Inclusive Capitalism, London, 2014).

“long-term horizons”,⁴⁸ and repurposes the corporation to be built upon a more egalitarian norm that confers primacy to stakeholders instead.⁴⁹ Several years ago, Raworth proposed the instinctively appealing idea of redefining the boundaries of economic activity to take place within a “safe and just space” for humanity, determined by natural metrics such as the amount of carbon emitted, and social metrics, such as the number of people facing hunger.⁵⁰ Proposals like these are a clarion call for not only a revamp of the economic system but for the shareholder primacy norm to be ousted.

Despite these laudable aims and the justifiable misgivings about shareholder primacy that fuel them, ambitions to oust the shareholder primacy model appear quixotic. The difficulty lies in shareholder primacy being entrenched within Anglo-Saxon jurisdictions more for cultural reasons than legal ones. While shareholder primacy is not legally enshrined by statute or otherwise,⁵¹ neither has company law imposed any limits on its ethos.⁵² Consequently, shareholder primacy and the maximisation of profit are so inextricably intertwined with the financial world that they have become its “reigning credo”.⁵³ With shareholder primacy often presumed to be superior to other financial models,⁵⁴ Hansmann and Kraakman have noted the pressure for corporate law to converge around the “shareholder-centered ideology” which now dominates “business, government, and legal elites in key commercial jurisdictions.”⁵⁵

The grafting of the shareholder primacy model onto liberal market economies has resulted in what is characterised as ‘path dependence’.⁵⁶ As Liao explains:

“The force of competition motivates efficient positions, and the Anglo-American cultural emphasis on free market capitalism in an era of multinational enterprises and global markets supports the endurance of shareholder primacy for the foreseeable future despite occasional unpleasant challenges.”⁵⁷

With economic forces constantly reinforcing the prevalence of shareholder primacy, jettisoning it entirely from Anglo-Saxon markets seems improbable.⁵⁸ The time frame that leading scientists proclaim we have to prevent global warming from reaching catastrophic levels moreover suggests that,⁵⁹ over the next ten years, effort may be better spent exploiting

⁴⁸ Richardson (n8), 17.

⁴⁹ Caroline Anstey, ‘We need an economic model that works for people and the planet’ (*World Economic Forum*, 23 September 2019) <<https://www.weforum.org/agenda/2019/09/how-to-make-markets-more-sustainable/>> accessed 16 September 2020.

⁵⁰ Kate Raworth, ‘A Safe and Just Space for Humanity: Can We Live within the Doughnut’ (2012) *Oxfam Discussion Papers*, 8.

⁵¹ Deakin (n9), 12; Min Yan (n7), 62-66.

⁵² Sjäffjell (n4), 144.

⁵³ Stavros Gadinis and Amelia Miazad, ‘Corporate Law and Social Risk’ (2020) *Vanderbilt Law Review* (forthcoming), available at SSRN: <https://ssrn.com/abstract=3441375>, 2.

⁵⁴ Carol Liao (n18), 282.

⁵⁵ Henry Hansmann and Reiner Kraakman, ‘The End of History for Corporate Law’ (2001) *Georgetown Law Journal* 89, 439-468, 439.

⁵⁶ Carol Liao (n18), 284.

⁵⁷ *Ibid*, 286.

⁵⁸ Sneirson (n11), 76.

⁵⁹ Jonathan Watts, ‘We have 12 years to limit climate change catastrophe, warns UN’ (*The Guardian*, 8 October 2018) <<https://www.theguardian.com/environment/2018/oct/08/global-warming-must-not-exceed-15c-warns-landmark-un-report>> accessed 16 September 2020.

shareholder primacy towards environmental objectives than seeking to replace or ignore it. The following section gives credence to this view.

D. Ineffectiveness of initiatives seeking to subvert shareholder primacy

While more initiatives are recognising, and attempting to leverage, the power of financial markets to agitate for change in corporate culture – one where businesses are cognisant of climate degradation and sustainability – some of these have not gained the traction desired. This is largely owed to the failure of such initiatives to recognise the immutability of the shareholder primacy norm.

One example is the divestment movement. Mainly targeted at pension funds and university endowments, the movement, which took off approximately six years ago, called on shareholders to divest away from the fossil fuel industry.⁶⁰ The overarching idea was that diverting cash flow away from the offending companies would cause a drop in their share prices,⁶¹ making them ever more unattractive as investments. However, the latest reports and studies have questioned the results of the divestment movement,⁶² with Bill Gates recently mocking it as probably “reduc[ing] about zero tonnes of emissions”.⁶³ The main problem is what is known as “arbitrage”.⁶⁴ As Harmes explains:

“[I]f a number of ethically-motivated investors sold-off the shares of a company with poor environmental performance, causing the stock price to drop, other investors would view that company as undervalued in market terms and would quickly purchase its shares causing the stock price to almost instantly return to its original value.”⁶⁵

The above warrants two observations. The first is that the divestment movement is still subservient to cold, financial logic that underscores shareholder primacy and profit maximisation as a prevailing norm. The second is how it highlights the limits of ethical compulsion in the investment market towards environmental stewardship. For moral suasion to have any real impact on the market, nothing short of universal preponderance of public opinion tends to be required.⁶⁶

Such reasons also explain why investors feel so insulated from the pressure of the ‘social licence’, another movement targeting companies.⁶⁷ Investors appear less vulnerable to governance pressures from non-state actors calling for a change in environmentally unfriendly practices, as “they are not directly responsible for greenhouse gas emissions”.⁶⁸ With any

⁶⁰ Richardson (n3), 325-326.

⁶¹ Emma Sjostrom, ‘Active ownership on environmental and social issues: What works?’ (2020) *Stockholm School of Economics* <<https://www.hhs.se/contentassets/8c081579b18b4c0b854d240b847f157e/full-report-active-ownership-emma-sjostrom-final.pdf>> accessed 16 September 2020, 5.

⁶² Cundill (n12), 612.

⁶³ Andrew Edgecliffe-Johnson and Billy Nauman, ‘Fossil fuel divestment has ‘zero’ climate impact, says Bill Gates’ (*Financial Times*, 18 September 2019) <<https://www.ft.com/content/21009e1c-d8c9-11e9-8f9b-77216ebe1f17>> accessed 16 September 2020.

⁶⁴ Harmes (n45), 108.

⁶⁵ *Ibid*, 108-109.

⁶⁶ Richardson (n41), 242.

⁶⁷ Neil Gunningham, ‘Environmental Law, Regulation and Governance: Shifting Architectures’ (2009) *Journal of Environmental Law* 21:2, 179-212, 194-195.

⁶⁸ Richardson (n3), 327.

moral complicity in the company's practices being, at most, indirect, most owners within companies face no real pressure to be accountable.⁶⁹ External stakeholder pressure may be felt by management. Yet, this is only to the extent that their companies' economic edge might be compromised from a loss of customer support.⁷⁰ This moreover gives way to more pernicious outcomes. Known as "green washing", corporate leaders may be tempted to manipulate a company's public image by making bold rhetorical statements about climate change, knowing that shareholder primacy will "ensure that only measures supported by a strong business case will actually be adopted."⁷¹

Understandably, some effort has gone into undermining shareholder primacy and profit maximisation as the 'guiding star' under which shareholders should invest. One notable attempt was the 2005 report by Freshfields.⁷² The Freshfields report claimed that much of the investment world operated on the misconception that the case of *Cowan v Scargill*⁷³ required investment decision-makers to maximise financial returns because "the courts [would] overturn decisions made without the profit-maximisation objective in mind".⁷⁴ Clarifying that *Cowan* only required that fiduciary investment powers be exercised for the purpose they were granted,⁷⁵ the implication was that investors or asset managers were free to integrate environmental, social, and governance (ESG) factors into their investment decisions.

However, the assumption that *Cowan*'s misinterpretation accounted for much of the reluctance of the investment community to integrate ESG into investments must be questioned. Even as investors were purportedly emancipated from this legal 'misnomer', there was observably little rise in ESG-related investment for the ten years following the release of the Freshfield report. Notably, yearly inflow into ESG funds only gained momentum in the last five years, with a significant jump of 53% only last year.⁷⁶ It does not help that, in all the research and studies perused for this paper, there is not one mention of how a renewed understanding of *Cowan*'s legal import cleared the way for ESG-related investments. The above suggests that investment decision-makers were, and continue to be, driven towards profit-maximisation (as informed by shareholder primacy), regardless of any perceived restraint imposed by any legal authority (even where wrongly interpreted).

The above examples demonstrate how resilient the shareholder primacy norm is, so much so that any meaningful endeavour to compel companies to embrace sustainability must ultimately "confront the challenge head on and explore whether sustainability falls in line with shareholders' interests".⁷⁷ At the same time, it calls for the realisation that shareholders wield

⁶⁹ Shamima Haque, Craig Deegan and Robert Inglis, 'Demand for, and impediments to, the disclosure of information about climate change-related corporate governance practices' (2016) *Accounting and Business Research* 46:6, 620-664, 653.

⁷⁰ Gunningham (n67), 210.

⁷¹ Sullivan (n2), 422.

⁷² Freshfields Bruckhaus Deringer, 'A legal framework for the integration of environmental, social and governance issues into institutional investment' (October 2005) *UNEP Finance Initiative* <https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf> accessed 16 September 2020.

⁷³ [1985] Ch 270.

⁷⁴ Freshfields (n72), 8-9.

⁷⁵ *Ibid*, 10.

⁷⁶ Imogen Tew, 'ESG funds see £124m inflows per week' (*Financial Times*, 30 October 2019) <<https://www.ftadviser.com/investments/2019/10/30/esg-funds-see-124m-inflows-per-week/>> accessed 16 September 2020.

⁷⁷ Gadinis (n53), 6.

significant institutional power which can, with the right motivations, be channeled towards environmental objectives. It thereby calls for a reorientation of the perception of shareholders as barriers, to one which sees them as potential collaborators.

III. THE PHENOMENON OF SHAREHOLDER ACTIVISM

As it happens, shareholders are being increasingly recognised for their instrumentality in “shaping the political agenda of firms by utilizing their ownership stakes and various political behaviors to urge firms to pay attention to certain issues”.⁷⁸ While there are several different methods by which shareholders are engaging with companies,⁷⁹ there are two in particular which are demonstrating an impact: (i) shareholder resolutions and voting, and (ii) the shaping of new norms. In expanding on this below, I show how shareholders are playing a pivotal role in facilitating, rather than hindering, the mobilisation of companies to achieve greater sustainability.⁸⁰

A. *Shareholder resolutions*

Shareholders stand in the unique position to influence companies by virtue of their ownership of shares. An important way this is accomplished is through shareholder resolutions – proposals that allow shareholders to exercise their ‘voice’ within companies and convey environmental objectives and desires to management.⁸¹ The past few years have witnessed a considerable uptake in the number of climate-related resolutions, particularly amongst energy companies.⁸² In fact, shareholder resolutions focused on environmental issues (such as climate change) ranked first in number among the various categories of proposals filed in 2018.⁸³ Success in these climate-related proposals, recently characterised by efforts to reduce emissions rather than simply disclose them, has been demonstrated by their increasing withdrawals – a sign that engagement with the company on the issue succeeded without needing to be placed to a vote.⁸⁴

Shareholder resolutions also play an important role in holding management to account. Specifically, they can be used to “challenge the re-election of boards that have shown

⁷⁸ Cynthia E Clark and Elise P Crawford, ‘Influencing Climate Change Policy: The Effect of Shareholder Pressure and Firm Environmental Performance’ (2012) *Business & Society* 51(1), 148-175, 149.

⁷⁹ Such methods include divestment and shareholder dialogue. Empirically, these two methods have either little or ambivalent evidence regarding their impact on companies’ adoption of more sustainable / environment-related practices (Cundill (n12)), thus explaining the chosen focus here.

⁸⁰ Joe Brooks, ‘From climate disclosure to action – It is time for investors to rock the vote’ (*ShareAction*, 25 November 2019) <<https://shareaction.org/from-climate-disclosure-to-action-it-is-time-for-investors-to-rock-the-vote/>> accessed 16 September 2020; Alyssa Heath et al, ‘Fiduciary Duty in 21st Century: Final Report’ (2019) *UNEP Financial Initiative* <https://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf> accessed 16 September 2020, 22.

⁸¹ Cundill (n12), 609, 614.

⁸² Mara L Stein, ‘More Shareholder Proposals Spotlight Climate Change’ (*Wall Street Journal*, 8 Feb 2018) <<https://www.wsj.com/articles/more-shareholder-proposals-spotlight-climate-change-1518127308?tesla=y>> accessed 16 September 2020.

⁸³ Maximilian Horster and Kosmas Papadopoulos, ‘Climate Change and Proxy Voting in the US and Europe’ (*Harvard Law School Forum on Corporate Governance*, 7 January 2019) <<https://corpgov.law.harvard.edu/2019/01/07/climate-change-and-proxy-voting-in-the-u-s-and-europe/>> accessed 16 September 2020.

⁸⁴ *Ibid.*

persistent inaction on climate change”,⁸⁵ even when no resolution dealing with an environmental issue *per se* is filed.⁸⁶ One promising demonstration in this regard was the ExxonMobil AGM that took place in December 2018. CA100+ investor signatories, comprising large asset managers such as BlackRock, voted against the re-election of ExxonMobil’s directors, largely on the basis that the board had a demonstrable lack of consideration for, and investor engagement related to, climate change risks.⁸⁷

Naturally, the lynchpin for a resolution to have lasting impact within the company is the passing of it through shareholders’ votes. Efforts have therefore been made to persuade investors to engage companies on climate-related issues by exercising their vote as “a cost-effective and impactful entry point”.⁸⁸ However, more often than not, shareholder resolutions related to climate change do not pass.⁸⁹ While occasional success such as ExxonMobil’s December 2018 AGM may be celebrated,⁹⁰ similar success was not achieved at the more recent ExxonMobil AGM in May 2020. All four resolutions which would have advanced even more ambitious climate strategy from the company were rejected.⁹¹ Signs indicate that climate petitions do garner support, with 16 ESG petitions passing in 2020 (at the time of this writing), two more than 2019.⁹² Yet, with a total of 429 climate resolutions filed during the 2020 proxy season in the US,⁹³ such numbers might still seem like a drop in the bucket.

Why ESG-related resolutions continue to be so deeply divisive requires us to revisit the earlier discussion on agency theory. As mentioned above, managers were mostly assured of being accountable to shareholders when they pursued the maximisation of profit, which formed the ‘common denominator’ of shareholder interests. However, agency theory becomes a dissatisfactory explanation when shareholder interests are discernably heterogenous. Previous shareholder activism may have centered more traditionally around the financial aspects of the company, but is today increasingly concerned with the environmental and social performance of a company.⁹⁴ Consequently, there is a growing fissure between the interests of most shareholders and those deemed as “non-financial shareholder activists”.⁹⁵

The interesting phenomenon, however, is that more shareholders are becoming concerned with the non-financial performance of companies – where votes in favour of ESG-related resolutions stood at roughly 10% in 2005, this grew to 29% in 2019.⁹⁶ The proposal at

⁸⁵ Brooks (n80).

⁸⁶ Horster (n83).

⁸⁷ ShareAction, ‘Voting Matters: Are asset managers using their proxy votes for climate action?’ (2019) *ShareAction* <<https://shareaction.org/wp-content/uploads/2019/11/Voting-Matters.pdf>> accessed 16 September 2020, 26-27.

⁸⁸ Asset Owners Disclosure Project, ‘Winning climate strategies: Practical solutions and building blocks for asset owners from beginner to best practice’ (2018) *ShareAction* <<https://aodproject.net/wp-content/uploads/2018/06/AODP-WinningStrategiesReport.pdf>> accessed on 16 September 2020, 51.

⁸⁹ Sjostrom (n61), 12.

⁹⁰ Stein (n 82).

⁹¹ Cecilia Keating, ‘ExxonMobil holds out against shareholder rebellion over ‘insufficient’ climate action’ (*GreenBiz*, 2 June 2020) <<https://www.greenbiz.com/article/exxonmobil-holds-out-against-shareholder-rebellion-over-insufficient-climate-action>> accessed 16 September 2020.

⁹² Neanda Salvaterra, ‘Writing the Future: Investors Pushing ESG Values Into Boardrooms’ (*Karma*, 17 August 2020) <<https://karmaimpact.com/writing-the-future-investors-pushing-esg-values-into-boardrooms/>> accessed 16 September 2020.

⁹³ *Ibid.*

⁹⁴ Cundill (n12), 606.

⁹⁵ *Ibid.*, 608.

⁹⁶ Sjostrom (n61), 12.

the ExxonMobil May 2020 AGM seeking greater lobbying disclosure by the company, for example, had 37.5% votes in favour.⁹⁷ This is, moreover, buttressed by the growing number of ESG-related resolutions filed by shareholders itself.⁹⁸ Such trends suggest an enlarging number of shareholders exhibiting environmental probity that promise to change company practices and attitudes towards climate change.

B. Shaping new norms

Additional to the above, shareholders have demonstrated their potential to impact standards and norms, both within the company and beyond. One key example is the mimetic effect that successful shareholder resolutions can have on the industry. Even where a resolution calling for particular CSR practices may have received a “close-call” success, i.e., garnered just over 50% of the votes, one study has demonstrated that similar practices are then implemented by product peer companies.⁹⁹ Additionally, such resolutions can have ripple effects on policy-making and the regulatory landscape by being a type of “political expression”, providing activists and politicians information about “what new concerns might be afoot”.¹⁰⁰

Even where proposals put forward by investors calling for a change in practice or management ostensibly fail, these are still capable of “spark[ing] changes in the board, management, or corporate practices in the aftermath of the vote”.¹⁰¹ One particular study found that firms targeted by shareholder resolutions calling for improvement to toxic release and emissions “improved their environmental performance in the following year, and this effect persisted in subsequent years”.¹⁰² In 2018, 8,100 Amazon employees signed a shareholders’ resolution urging it to do more to address climate change. While the resolution ultimately failed, Amazon nonetheless implemented goals which demonstrated a stronger commitment to reducing its carbon footprint.¹⁰³

Recent trends also point towards climate-conscious shareholders having a growing sphere of influence over international accounting standards. While the “qualitative nature” of climate risks has caused challenges in translating such risks into quantifiable accounting metrics,¹⁰⁴ the International Accounting Standards Board (IASB) released a paper in 2019 pronouncing how climate-related risks are *already* incorporated under the International Financial Reporting Standards.¹⁰⁵ Specifically, it explains how climate-related issues may be ‘material’ risks warranting disclosure in financial statements given that investors regard them as important to their decision-making.¹⁰⁶ In other words, climate risks are material because investors say they are.

⁹⁷ Keating (n91).

⁹⁸ George Serafeim, ‘Investors as Stewards of the Commons’ (2018) *Journal of Applied Corporate Finance* Vol 30(2), 8-17, 9.

⁹⁹ Sjoström (n61), 14.

¹⁰⁰ Clark (n78), 153.

¹⁰¹ Ho (n15), 93.

¹⁰² Sjoström (n61), 13.

¹⁰³ Schmidt (n31).

¹⁰⁴ Ho (n15), 81.

¹⁰⁵ Nick Anderson, ‘IFRS Standards and climate-related disclosures’ (2019) IFRS <<https://www.ifrs.org/news-and-events/2019/11/nick-anderson-ifrs-standards-and-climate-related-disclosures/>> accessed 16 September 2020.

¹⁰⁶ *Ibid*, 3.

The reasoning is admittedly circuitous and, clearly, no actual amendments to existing standards were proposed. Yet, the IASB paper is already having an impact – with climate-related assumptions about current and future assets (such as the future price of oil) being disclosable information that may affect investor decision-making, major oil companies such as BP and Shell have been forced to write down the value of their assets by billions of dollars.¹⁰⁷ In this way, the market is one step closer to addressing its general failure to reflect the “enduring value of companies’ (un)sustainability performance.”¹⁰⁸ The influence of shareholders in this cannot be understated – the IASB paper attributes its release to a growing number of investors questioning it on why climate change was not featured in accounting standards.¹⁰⁹

The above illustrates that shareholders not only influence changes within the companies they are invested in, but can play a proselytising role in shaping norms within industries, encouraging greater stewardship of the environment. This can be an empowering revelation for a shareholder. As Sjoström states:

“Over time, certain business conduct that used to be *comme-il-faut* can come to be regarded as unthinkable. This insight may be useful for investors: seeking to influence norms could be a strategy in itself. If an investor sets out to change norms, this might change their engagement targets from single corporations to sector-wide engagements or engagement at the policy level, as well as engagement together with a broader set of investors that can signal a desired norm-shift.”¹¹⁰

IV. UNCOVERING SHAREHOLDER MOTIVATIONS

The question thus arises as to why we are witnessing a transformation of the shareholder’s traditional role as an agent of the market to an agent of society.¹¹¹ This is particularly when shareholder primacy eschews the consideration of third party interests against the company’s own bottom line.¹¹² In brief, my analysis below shows that increased shareholder action in the arena of climate change is attributable to two broad factors: the first is the increasingly compelling business case for climate action (section A), and the second is the rising ownership by institutional investors in most public companies (section B). In this way, the primacy afforded to shareholders has served to be a surprising boon in mobilising companies towards the fight against climate change.

A. The business case for climate action

¹⁰⁷ Paul Lee, ‘Accounting for climate: getting the numbers investors need’ (PRI, 7 July 2020) <<https://www.unpri.org/pri-blog/accounting-for-climate-getting-the-numbers-investors-need/6040.article>> accessed 16 September 2020.

¹⁰⁸ Beate Sjøfjell and Benjamin Richardson, ‘The future of company law and sustainability’ in *Company Law and Sustainability: Legal Barriers and Opportunities* (CUP 2016), 312-340, 325.

¹⁰⁹ Anderson (n105), 1.

¹¹⁰ Sjoström (n61), 21.

¹¹¹ Deakin (n9), 15.

¹¹² Gadinis (n53), 6.

If economic concerns “drown out voices that call for environmental ethics”,¹¹³ then the sound of sizeable economic losses and gains occasioned by the climate problem should be better heard. This section first discusses the financial risks of climate change, and then explores the financial opportunities that it brings about. I then examine how and why these have had a bearing on shareholders.

(i) *Financial risks of climate change*

Broadly, research suggests that the overall financial cost of climate change could amount to US\$551 trillion should temperatures rise by 3.7 degrees by 2100¹¹⁴ – a sobering figure when one considers such rise to be well within estimates if greenhouse gas emissions continue along current trajectories.¹¹⁵ Growing evidence moreover suggests that these costs are more tangible and will manifest far sooner than previously thought.¹¹⁶

Such studies have allowed a consensus to emerge that climate change presents three broad types of risks: physical risk, transition risk, and liability risk. Some continue to prevaricate on how threatening liability risks really are, given that the nature of climate change often makes ascribing responsibility for harm challenging.¹¹⁷ Nonetheless, businesses are becoming painfully aware of the financial impact that physical and transitional risks pose.¹¹⁸

Physical risks, which arise from the physical effects of climate change, manifest in rising sea levels and a growing frequency of extreme weather-related events like droughts, storms, and floods.¹¹⁹ This “new normal”¹²⁰ promises to severely impact investments over a plethora of sectors including agriculture, fisheries, health care, tourism, and property.¹²¹ For example, droughts in 2010 cost Bunge Ltd, an agribusiness and food company based in Missouri, US\$56 million in quarterly losses in its sugar and bioenergy segments.¹²² Hershey’s was representative of the entire chocolate industry when it reported to the Carbon Disclosure Project that its supply of agricultural commodities, such as cocoa, nuts, and sweeteners, are vulnerable to unpredictably changing rainfall patterns where these crops grow. This presented “a long-term physical risk to commodity supplies”.¹²³ In similar fashion, Wal-Mart acknowledged that many of its stores, which remain within five to ten miles of the US coastline, are at risk from sea level rise and extreme weather events such as Hurricane

¹¹³ Eric W Orts, ‘A Reflexive Model of Environmental Regulation’ (1995) *Business Ethics Quarterly* Vol 5(4), 779-794, 789.

¹¹⁴ David Wallace-Wells, ‘Crisis Capitalism’ in *The Uninhabitable Earth* (Allen Lane 2019), 166.

¹¹⁵ Tom Miles, ‘Global temperatures on track for 3-5 degree rise by 2100: U.N.’ (*Reuters*, 29 November 2018) <<https://www.reuters.com/article/us-climate-change-un/global-temperatures-on-track-for-3-5-degree-rise-by-2100-u-n-idUSKCN1NY186>> accessed 16 September 2020.

¹¹⁶ Thomas (n40), 3-4.

¹¹⁷ Pfeifer (n39), 251.

¹¹⁸ Nicolette Bartlett and Tom Coleman, ‘Major Risk or Rosy Opportunity: Are Companies Ready for Climate Change?’ (2019) *Carbon Disclosure Project (CDP)* <https://6fefcbb86e61af1b2fc4-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/004/588/original/CDP_Climate_Change_report_2019.pdf?1562321876> accessed 16 September 2020, 2.

¹¹⁹ Carney (n43), 5.

¹²⁰ Horster (n83).

¹²¹ Pfeifer (n39), 250.

¹²² Whelan (n6).

¹²³ Raj Aggarwal and Sandra Dow, ‘Corporate governance and business strategies for climate change and environmental mitigation’ (2012) *The European Journal of Finance* Vol 18(3-4), 311-331, 313-314.

Katrina.¹²⁴ As these extreme weather events continue to rise, so too will the price tag on climate change.

Transition risks, on the other hand, refer to the broad set of costs associated with companies being required to adjust to a lower-carbon economy due to changes in policy, technology, or even consumer patterns.¹²⁵ In the previous decade, a major source of transition risks were the policies which required the internalisation of greenhouse gas emissions, a prime example of which was the EU Emission Trading Scheme.¹²⁶ These days, the market is increasingly identifying assets which threaten to become “stranded”, i.e., “investments that become obsolete due to regulatory, environmental, or market constraints.”¹²⁷ One prime example is what appears to be an inevitable shift away from fossil fuels – a 2018 joint study demonstrates that this shift will take place regardless of whether climate policies are adopted.¹²⁸ Not only is the bursting of this ‘carbon bubble’ imminent; it is likely to take place far more swiftly than anticipated.¹²⁹

The sobering reality is that shareholders cannot fully hedge against such risks. Research demonstrates that the best efforts at changing asset allocations and investing in sectors which present low climate risks can only offset, at most, half of the negative impacts climate change is destined to wreak on financial portfolios.¹³⁰ Contrary to popular belief, therefore, climate change presents a short-term, system-wide risk for which there is little escape unless economy-wide efforts are undertaken to mitigate it.

(ii) *Financial opportunities abound*

The financial implications of climate change are not only materialising in downside risk. The upside in transitioning to more sustainable practices is also increasingly palpable.

This is not least because of a “surging green energy sector”,¹³¹ greatly assisted by the decreasing prices of renewable energy.¹³² The cost of energy from solar photovoltaics, for example, fell 82% from 2010 to 2019.¹³³ Recent revisions made to the estimated “levelised cost” for wind and solar power generation in the near future also provide a compelling case for using renewable technologies to generate electricity – what the UK government presumed the cost of electricity generated from offshore windfarms would be in 2025 is now 47% lower than thought in 2016.¹³⁴ The fact that such prices have been achieved despite diminishing

¹²⁴ *Ibid*, 314.

¹²⁵ Carney (n43), 6.

¹²⁶ Pfeifer (n39), 250-251.

¹²⁷ Whelan (n6).

¹²⁸ J-F Mercure et al, ‘Macroeconomic impact of stranded fossil fuel assets’ (2018) *Nature Climate Change* Vol 8, 588-596.

¹²⁹ Cambridge Institute for Sustainability Leadership, ‘Unhedgeable risk: How climate change sentiment impacts investment’ (2015) <<https://www.cisl.cam.ac.uk/resources/publication-pdfs/unhedgeable-risk.pdf>> accessed 16 September 2020, 30.

¹³⁰ *Ibid*, 5.

¹³¹ Richardson (n3), 338.

¹³² Pfeifer (n39), 257.

¹³³ IRENA, ‘How Falling Costs Make Renewables a Cost-effective Investment’ (IRENA, 2 June 2020) <<https://www.irena.org/newsroom/articles/2020/Jun/How-Falling-Costs-Make-Renewables-a-Cost-effective-Investment>> accessed 16 September 2020.

¹³⁴ Simon Evans, ‘Electricity generated from wind and solar is 30-50% cheaper than previously thought, according to newly published UK government figures’ (*Carbon Brief*, 27 August 2020) <<https://www.carbonbrief.org/wind-and-solar-are-30-50-cheaper-than-thought-admits-uk-government>> accessed 16 September 2020.

government subsidies is testament to its financial success.¹³⁵ It is therefore unsurprising that even socially responsible investment funds see investment into the renewable energy sector not for its virtuous properties, but its financial returns.¹³⁶

The green economy is not only boosted by the growing attractiveness of cleaner energy, but in the change of consumption patterns as well. With growing demand for low emissions products and services, CDP has reported that out of 500 of the biggest companies surveyed, 225 reported climate-related business opportunities totalling a potential of over US\$2.1 trillion, almost all of which are predicted to materialise over the short to medium term.¹³⁷ Unilever itself has found its “sustainable living” brands, including Dove and Hellmann’s, to be “growing much faster than its other brands”.¹³⁸ Therefore, even if not every company sees its bottom line being threatened by the physical risks of climate change, such as Google,¹³⁹ those that do nothing about it make themselves vulnerable to significant reputational risk. Indeed, this explains why companies with higher profiles and revenues have been observed to be more likely to have mechanisms in place, such as the appointment of high-ranking executives, to manage climate issues.¹⁴⁰

The business case for sustainability is additionally buttressed by the broad trends observed of the financial performance of companies which incorporate sustainability into their practices. Overall, research suggests that “ESG considerations have affected the valuation and performance of companies, including with respect to their cost of capital and profitability”.¹⁴¹ In a review of over 200 studies on sustainability and corporate performance, 90% concluded that good ESG standards lowered capital cost, and another 88% demonstrated that good ESG practices led to better operational performance.¹⁴²

Such encouraging trends have also been reflected in the performance of stocks. Studies have demonstrated that companies which have had best practices in climate change strategy and risk management outperformed their counterparts in stock returns in the last decade.¹⁴³ From at least 2013-2018, investment indexes which excluded any company with coal or fossil fuel reserves had performed better than those which did not.¹⁴⁴ This is why ClientEarth has called on investors to “position their portfolios to take advantage of trends that can be

¹³⁵ Robert Nash, ‘Why investors should act in response to climate-related risks and opportunities: A survey of current evidence’ (2018) *ClientEarth* <<https://www.documents.clientearth.org/wp-content/uploads/library/2018-08-13-why-investors-should-act-in-response-to-climate-related-risks-and-opportunities-a-survey-of-current-evidence-coll-en.pdf>> accessed 16 September 2020, 22-23.

¹³⁶ Richardson (n3), 338.

¹³⁷ Bartlett (n118), 5.

¹³⁸ Schmidt (n31).

¹³⁹ Aggarwal (n123), 314.

¹⁴⁰ Air Pollution Consultant, ‘Corporate Governance and Climate Change’ (2013) *Air Pollution Consultant* Vol 23(3), 1.9-1.10.

¹⁴¹ Olwyn Alexander, ‘Investors and asset managers are chasing a new shade of green’ (*Strategy+Business*, 14 April 2020) <<https://www.strategy-business.com/blog/Investors-and-asset-managers-are-chasing-a-new-shade-of-green?gko=2a745>> accessed 16 September 2020.

¹⁴² Whelan (n6).

¹⁴³ Chris McKnett, ‘The investment logic for sustainability’ (12 February 2014) <<https://www.youtube.com/watch?v=rpOwTspdwkI>> accessed 16 September 2020; Robert G Eccles, Ioannis Ioannou and George Serafeim, ‘The Impact of Corporate Sustainability on Organizational Processes and Performance’ (2014) *Management Science* Vol 60(11), 2835-2857, 2835.

¹⁴⁴ Nash (n135), 21-22.

identified now and be resilient to unpredictable disruptions and shocks that may manifest in future.”¹⁴⁵

Unsurprisingly, therefore, investment firms are paying greater attention to their ESG performance now more than ever.¹⁴⁶ When surveyed in 2019, 76% of asset owners reported that they consider ESG issues when investing in hedge funds – a jump from 53% in 2017.¹⁴⁷ The existing evidence already demonstrates that investors’ portfolios are leaning more in favour of “low-carbon and climate-resilient sectors” by investing in renewable energy technologies and infrastructures.¹⁴⁸ Sustainability-related investments have equally enjoyed an explosive rise in the recent past. Funds flowing into sustainable investing ballooned to US\$20.6 billion in 2019, more than four times the previous record set in the year before.¹⁴⁹ Currently, the market still identifies this as “responsible investing”.¹⁵⁰ Yet, such classification may mean little should the entire investment community make their decisions guided by ESG issues, which may result in “irresponsible” outlier companies shoehorned to adopt more environmentally responsible practices.¹⁵¹

(iii) *The shareholder rationale*

To believe that shareholders’ rapid turn to environmentally-friendly investing has sprung from a collective ethical backbone would be naïve. With Anglo-Saxon economies still indoctrinated with the shareholder primacy norm, what appears to be happening is a greater appreciation that the pursuit of environmental objectives is aligning with financial ones.

Gadinis and Miazad seek to conceptualise the consideration of climate change and sustainability into investment decision-making, not as profit-making, but as an effective risk management tool. As they state, “by operationalizing their commitment to these values [of sustainability], companies are... seeking to avert the reputational uproar, stock price drop and legal troubles following misconduct.”¹⁵² Such a framing is supported by debacles such as the explosion of the BP Deepwater Horizon oil rig in 2010, which cost BP approximately £47.3bn in compensation and clean-up costs.¹⁵³ Unsurprisingly, the share price sank to its 14-year low later that same year,¹⁵⁴ wiping out many shareholders’ investment returns. Those in the finance industry supporting ESG-related investments believe that integrating an ESG framework into one’s investment decision-making would have served as a canary in the coalmine – with BP’s

¹⁴⁵*Ibid.*, 4.

¹⁴⁶ Gadinis (n53), 20.

¹⁴⁷ Heath (n80), 19.

¹⁴⁸ Nash (n135), 4-5.

¹⁴⁹ Corporate Citizenship, ‘Why Responsible Business will Shape the “New Normal”’ (*Corporate Citizenship*, 7 April 2020) <<https://corporate-citizenship.com/2020/04/07/why-responsible-business-will-shape-the-new-normal/>> accessed 16 September 2020.

¹⁵⁰ Ben Jacobsen, ‘Institutional Investor Support for Climate Change Resolutions: A New Challenge to Capitalism or Co-opted Activism?’ (2013) *Critical Studies on Corporate Responsibility, Governance and Sustainability* Vol 5, 279-308.

¹⁵¹ Forest L Reinhardt, Robert N Stavins, and Richard HK Vietor, ‘Corporate Social Responsibility Through an Economic Lens’ (2008) *Review of Environmental Economics and Policy* Vol 2(2), 219-239, 226.

¹⁵² Gadinis (n53), 22.

¹⁵³ Ron Bousso, ‘BP Deepwater Horizon cost balloon to \$65 billion’ (*Reuters*, 16 January 2018) <<https://uk.reuters.com/article/uk-bp-deepwaterhorizon/bp-deepwater-horizon-costs-balloon-to-65-billion-idUKKBNIF5006>> accessed 16 September 2020.

¹⁵⁴ Carola Hoyos and Anousha Sakoui, ‘BP’s shares hit 14-year low’ (*Financial Times*, 25 June 2010) <<https://www.ft.com/content/5990378a-8052-11df-8b9e-00144feabdc0>> accessed 16 September 2020; Heath (n80), 18.

wilful misconduct and gross negligence found to have caused the oil spill,¹⁵⁵ an investor would have known to downgrade BP based on ESG-related factors, and avoid being invested in it when the Deepwater Horizon event occurred.¹⁵⁶

Consequently, the consideration of environmental issues by investors can be an effective means by which significant losses in market value can be avoided.¹⁵⁷ Nonetheless, whether one incorporates ESG factors to make profit or manage risk is hardly significant. Both rely on the argument that doing is in line with a stronger business case and, indeed, the concept of shareholder primacy.¹⁵⁸ As Ho explains, ESG-oriented investing is grounded on traditional economic rationales: “The two primary rationales that together form the “business case” for this form of “responsible investment” are the prospect of higher long-term returns, and improved firm-level risk management and portfolio-level risk analysis.”¹⁵⁹ Indeed, a May 2018 CFA Institute survey on ESG integration concluded that a proven link between ESG factors and financial performance would serve as compelling motivation for investors (at least in the US) that have yet to integrate ESG factors in their investment practices to do so.¹⁶⁰

Despite seemingly selfish motivations, shareholder interest in such ESG-related issues has also driven better engagement with a wider set of stakeholder interests. If the “evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment”,¹⁶¹ and – as Gadinis and Miazad posit – as a way to manage risk, it becomes critical to engage and learn from key stakeholders as part of a meaningful assessment. Only through “regular dialogue with stakeholders and continual iteration” can a company be better able to “anticipate and react to economic, social, environmental, and regulatory changes as they arise”.¹⁶² This dovetails with latest studies suggesting firms employing a “stakeholder model” positively impacts business performance, even in strict financial terms.¹⁶³ As Deakin states, “in serving their own interests, they serve those of the other stakeholders too.”¹⁶⁴

B. Key role of institutional shareholders

In studying the place of shareholders in this discourse, institutional shareholders deserve special mention. In this section, I first provide an overview of who they are and how they have been traditionally perceived *vis-à-vis* climate change. I then analyse how and why this outlook is changing such that institutional shareholders are becoming more vested in sustainability. I end with examining how the prioritisation of sustainability by institutional shareholders has impacted the market.

¹⁵⁵ BBC News, ‘BP found ‘grossly negligent’ in 2010 Gulf oil spill’ (BBC News, 4 September 2014) <<https://www.bbc.co.uk/news/business-29069184>> accessed 16 September 2020.

¹⁵⁶ Business Insider, ‘How ESG Metrics Work and Why All Investors Should Care’ (7 May 2018) <https://www.youtube.com/watch?v=4LPRQaG83Ls&feature=emb_rel_end> accessed 16 September 2020.

¹⁵⁷ Aggarwal (n123), 311.

¹⁵⁸ Gadinis (n53), 15.

¹⁵⁹ Ho (n15), 82.

¹⁶⁰ Heath (n80), 18.

¹⁶¹ Will Martindale, Rory Sullivan and Nathan Fabian, ‘How Asset Owners can Drive Responsible Investment’ (2016) *Principles for Responsible Investment* <<https://www.unpri.org/download?ac=1398>> accessed 16 September 2020, 4.

¹⁶² Whelan (n6).

¹⁶³ Sneirson (n11), 85.

¹⁶⁴ Deakin (n12), 13.

(i) *Who are institutional shareholders?*

Institutional shareholders or investors essentially refer to the financial institutions that are invested in companies, often holding the lion's share of their stocks.¹⁶⁵ While institutional investors are the named shareholders in these companies, they usually invest on behalf of third parties who provide the funds. Institutional investors therefore include “public and private pension funds, mutual funds, insurance companies, and banks.”¹⁶⁶

This immense shareholding power institutional investors tend to possess is a feature of modern capitalism. This rise of institutional ownership of stocks began sometime in the 1970s, and today represents roughly 80% of the market value of US stocks.¹⁶⁷ Buoyed by the corporate norm of shareholder primacy, such concentrated ownership among a minute number of shareholders has meant that the management within a company is more likely to attend to the concerns of these shareholders.¹⁶⁸ It also means that, by virtue of their vote, institutional investors can make the difference between whether a particular resolution passes or not, including climate-related shareholder proposals.¹⁶⁹

Efforts have therefore sought to leverage the enormous potential for institutional investors to steer the business world towards greater sustainability. The UK Stewardship Code, a “set of ‘soft’ best practices”, encourages shareholder engagement amongst institutions to “assist the efficient operation of the economy and promote its wider social impact”, including instilling ‘long-term success’ within companies.¹⁷⁰ The Investing in a Just Transition Initiative, partnered with and funded by PRI, also recognises the capacity of institutional investors to move the entire market through their corporate engagement and reallocation of capital.¹⁷¹

Despite the foregoing, the traditional orthodoxy has been that institutional shareholders are predominantly self-interested and espouse the view “that companies must be managed in the best interests of shareholders”.¹⁷² In this connection, institutional shareholders are equally seen to perpetuate the short-term outlook of financial markets. As Sjäfjell et al state:

“... major institutional shareholders themselves face pressures that encourage them to focus strongly on short-term share price maximisation. Pension funds

¹⁶⁵ Young (n5), 5.

¹⁶⁶ Ho (n15), 64.

¹⁶⁷ Patrick Jahnke, ‘Ownership concentration and institutional investors’ governance through voice and exit’ (2019) *Business and Politics* 21(3), 327-350, 327-328.

¹⁶⁸ Ho (n15), 65.

¹⁶⁹ James Phillips, ‘Do climate change resolutions erode shareholder value’ (*Professional Pensions*, 11 June 2018) <<https://www.professionalpensions.com/analysis/1021111/-climate-change-resolutions-erode-shareholder-value>> accessed 16 September 2020.

¹⁷⁰ Dionysia Katelouzou, ‘Shareholder Stewardship: A Case of (Re)Embedding the Institutional Investors and the Corporation?’ in Sjäfjell (n11), 581-584.

¹⁷¹ Nick Robins, Vanda Brunsting, and David Wood, ‘Climate change and the just transition: A guide for investor action’ (2018) *Grantham Research Institute on Climate Change and the Environment* <<https://www.unpri.org/download?ac=9452>> accessed 16 September 2020.

¹⁷² Sneirson (n11), 84.

need cash to meet current obligations to retirees, and many mutual funds compete for investor dollars on the basis of quarterly or annual returns. Far from being a potential solution to the short-termism problem, institutional shareholders often exacerbate the problem.”¹⁷³

Harmes echoes this perception, mainly attributing such contracted horizons to the competitive nature of the industry in which pressure to attract and retain customers requires institutional investors to ensure their funds perform strongly in the short-term.¹⁷⁴ Consequently, while hopes have been entertained for over 20 years that institutional shareholders could usher in “a new era of corporate social responsibility”, these have been largely dismissed.¹⁷⁵

(ii) *A different kind of business case*

In spite of the above, this perception warrants reexamination. In this respect, the view that greater institutional ownership is associated with “lower scores on environmental policy enactment” is becoming increasingly outdated.¹⁷⁶

Indeed, the latest empirical literature suggests that firms which have more institutional ownership are more likely to showcase “higher performance in their environmental and social profiles”.¹⁷⁷ Such statistics are buttressed by headline news such as BlackRock, the world’s largest asset manager, announcing to clients in January 2020 that it would make “sustainability integral to the way BlackRock manages risk, constructs portfolios, designs products, and engages with companies”.¹⁷⁸ Interestingly, a survey conducted by PwC in 2019 among institutional investors and retail investors all over the world found that ESG concerns ranked third in priorities amongst investors in Europe, North America and Asia Pacific,¹⁷⁹ with much of this contributed by the institutional investors surveyed.¹⁸⁰ What this means is that institutional investors are increasingly basing their investment decisions on information about a company’s ESG practices (including how such companies address its greenhouse gas emissions).¹⁸¹

The above raises the question as to how institutional investors, long viewed as an obstacle to sustainability, are now becoming its emerging champion. Undergirding the answer to this has already been touched upon above, i.e., that the business case for climate action and sustainability is becoming increasingly persuasive. Yet, how that business case is conceived of by institutional investors departs from its traditional conceptualisation in two material respects: the first relates to the time horizons of most of the investments undertaken by

¹⁷³ Sjøfjell (n4), 122.

¹⁷⁴ Harmes (n45), 103-104.

¹⁷⁵ Ho (n15), 80.

¹⁷⁶ Aggarwal (n123), 328.

¹⁷⁷ Gadinis (n53), 46.

¹⁷⁸ Laurence Fink et al, ‘Sustainability as BlackRock’s New Standard for Investing’ (BlackRock, January 2020) <<https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter>> accessed 16 September 2020.

¹⁷⁹ PwC, ‘Asset and wealth management revolution: Investor perspectives’ (PwC, 2019) <<https://www.pwc.com/gx/en/industries/financial-services/assets/pwc-awm-revolution-screen.pdf>> accessed 16 September 2020, 8.

¹⁸⁰ Alexander (n141).

¹⁸¹ Young (n5), 5-6.

institutional investors, and the second relates to the universe of assets such institutional investors tend to hold. Each of these is explored in turn.

One key reason institutional investors have jumped on the sustainability bandwagon relates to the manner in which most of their funds are invested. Institutional investors, such as pension funds, are often invested in funds which “aim to optimise returns over 15-30 years”.¹⁸² Additionally, institutional investors, such as passive fund managers, often invest their funds to track a particular benchmark which dictates the buying of a set number of stocks in an index. Such stocks will not be sold by such passive fund managers so long as it remains within this benchmark.¹⁸³ This makes it difficult for such investors to liquidate their holdings easily, even if they underperform but remain within the benchmark.¹⁸⁴ These factors collectively lead large institutional investors, such as index funds, to look for success in these stocks over a longer time horizon.¹⁸⁵

With environmental risks such as climate change manifesting over longer periods of time,¹⁸⁶ such risks pose a real and tangible threat to the performance of such funds which operate on the above business model. At the same time, corporate strategies that increase share prices in the short-term look unattractive, particularly if they cause a detriment to longer-term performance.¹⁸⁷ Moreover, without the ability to quickly exit and divest from any one company in the index, such investors are highly motivated to engage with management to mitigate negative environmental impacts.¹⁸⁸ As Jahnke states:

“With their long time [sic] horizons and common ownership they are able to provide the “commitment mechanism” necessary to ensure that companies work together to internalize externalities created within each industry.”¹⁸⁹

That stayed commitment, in contrast to the fleeting interest other kinds of shareholders tend to possess,¹⁹⁰ contributes to an increasingly popular characterisation of these large index investors acting as “stewards of the commons”.¹⁹¹ If indeed, as argued above, the reluctance of the market to integrate sustainability has been the dissonance between its short-term outlook and the long-term impact of climate change, institutional investors represent, within the investment community, a bridge to that divide.

The next reason is the phenomenon known as “universal ownership” – by virtue of their enormous portfolios, large institutional investors often diversify their holdings across the market, whether because of “prudent financial standards”,¹⁹² or by virtue of the business practices mentioned above. Consequently, these investors will essentially have a share in almost every company, and “thus a slice of the entire economy.”¹⁹³ Should any short-term benefit be gained from one company externalising its social and environmental costs, this

¹⁸² Nash (n135), 18.

¹⁸³ Jahnke (n167), 336.

¹⁸⁴ Gadinis (n53), 48.

¹⁸⁵ Andersson (n41), 30.

¹⁸⁶ Whelan (n6).

¹⁸⁷ Jahnke (n167), 343.

¹⁸⁸ Serafeim (n98).

¹⁸⁹ Jahnke (n167), 347.

¹⁹⁰ Sjäfjell (n108), 325.

¹⁹¹ Serafeim (n98).

¹⁹² Deakin (n9), 16.

¹⁹³ Jahnke (n170), 343.

would be more than offset by the financial detriment caused when such externalities negatively impact their other investments.¹⁹⁴ In other words, such universal owners will eventually be, in some form or another, the bearers of any externalities produced by any one company.

The economy-wide danger of climate change therefore poses a distinct and systemic risk to the investments such large asset managers collectively hold,¹⁹⁵ one which is “practically impossible to diversify against”.¹⁹⁶ As such, these universal investors are strongly incentivised to “attend to the long-term health of the broader economy”.¹⁹⁷ In this way, while such institutional investors still chase the “business case” of their investments, it no longer refers to the success of a singular company or even group of companies – to the universal owner, the pursuit of the “business case” means preserving the well-being of the entire market.

(iii) *Impact of institutional ownership*

As a result of the foregoing, institutional investors are throwing their weight behind shareholder initiatives to promote the consideration of ESG factors and sustainability. Critically, the investment landscape is changing as a result, one that has seen an increase in sustainability performances in companies driven by the long-term interests of institutional investors.¹⁹⁸ One contributing factor to this changing landscape has been the growing dominance of institutional investors in the shareholding structures of public companies itself.¹⁹⁹ From 2002 to 2016, the average percentage of shares collectively held by large index investors, which include BlackRock, Vanguard and State Street, in over 67,000 US companies increased from roughly 2.5% to nearly 12% (on an equal-weighted basis).²⁰⁰

As companies continue to see a higher constitution of institutional investors with such long-term interests in the make-up of their shareholding profiles, not only are the number of ESG shareholder resolutions likely to rise,²⁰¹ so too will the support of them. Such rising dominance has also made it likelier for institutional investors to insist on greater transparency in a company’s disclosure of ESG-related issues, such as its climate change risk.²⁰² Evidence has moreover shown that the greater the quality of disclosure by companies, the lower the cost of capital, and the greater interest institutional investors have in investing in those companies,²⁰³ causing a mutually reinforcing cycle in which companies are incentivised to act sustainably. Additionally, such disclosures provide an avenue for greater stakeholder scrutiny of a company’s climate policies and risk.

The reliance on institutional investors as champions for sustainability represents a shifting corporate culture. Irrespective of one’s level of comfort with so much corporate power concentrated amongst so few, it is clear that advocates for sustainability are increasingly

¹⁹⁴ Richardson (n41), 238.

¹⁹⁵ Pfeifer (n39), 252.

¹⁹⁶ Gadinis (n53), 49.

¹⁹⁷ Ho (n15), 84.

¹⁹⁸ Kruitwagen (n33), 26.

¹⁹⁹ Gadinis (n53), 44.

²⁰⁰ Serafeim (n98), 12.

²⁰¹ Gadinis (n53), 46.

²⁰² Aggarwal (n123), 317.

²⁰³ Andreas GF Hoepfner, Arleta AA Majoch, and Xiao Y Zhou, ‘Does an Asset Owner’s Institutional Setting Influence its Decision to Sign the Principles for Responsible Investment?’ (2019) *Journal of Business Ethics* (forthcoming), 1-26, 6.

relying on institutional investors to mitigate climate change and represent the interests of the environment and the long-term. PRI has in particular sought to capitalise on their power to promote “the integration of ESG issues within internal investment practices, by financial intermediaries, and down the investment chain to portfolio companies.”²⁰⁴ As Katelouzou articulates, “To conceptualise institutional investors as becoming a force for corporate responsibility and the protection of wider stakeholder interest is a paradigm shift from neoclassical economics, and the prevailing private, contractarian role of the shareholder.”²⁰⁵

V. THE LIMITATIONS OF THE SHAREHOLDER

Understandably, one may harbour apprehension that simply pursuing shareholder interests can steer businesses towards acting against climate change – after all, as already identified above, it was shareholder capitalism and the obsession with the ‘business case’ which arguably caused climate change to begin with. It would therefore be remiss to not discuss the limitations of the potential for shareholders to drive companies towards greater climate action. Indeed, there are several structural difficulties that limit the ability of shareholders to advance the climate change agenda. In this Part, I first explore those difficulties, before turning to potential solutions worth exploring.

A. *Limitations*

First, unifying the widely dispersed shareholding in a company to single-mindedly work towards greater environmental stewardship requires overcoming several challenging hurdles. As mentioned above, the diversity in ownership will often mean equally diverse interests. Even where institutional investors are keen on engaging management, and the cost of that engagement for them has reached negligible levels today,²⁰⁶ they still represent the minority in the entire shareholding of the company. Working to align their interests with the rest of the shareholders usually requires a vast amount of effort and resources that is not often practicable or proportionate to the benefit that may accrue.²⁰⁷ This is not to mention legislative restrictions that may stymie the advancement of climate-related shareholder resolutions. One prime example is the EU Shareholders’ Rights Directive, which requires shareholders (in countries which enforce this directive) to hold at least 5% in a company to propose resolutions.²⁰⁸

This is why several scholars insist that the enormous influence shareholders inherently have in companies can only be leveraged when shareholders collaborate.²⁰⁹ As Elson and Goossen state, “If a significant number of a corporation’s owners believe that climate change is an issue of importance, then boards must appropriately and effectively react”.²¹⁰ Signs indicate that the strategy of building coalitions has been gaining traction.²¹¹ Yet, the counterforce of hedge funds and private equity funds, which are far more concerned with

²⁰⁴ Ho (n15), 81.

²⁰⁵ Katelouzou (n170), 584-585.

²⁰⁶ Jahnke (n167), 328-329.

²⁰⁷ Sjäfjell (n4), 143.

²⁰⁸ Shareholder Rights Directive (EU) 2017/828 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (2017) OJ L 132.

²⁰⁹ Kruitwagen (n33), 25; Pfeifer (n39), 260.

²¹⁰ Elson (n44), 42.

²¹¹ Horster (n83).

short-term returns,²¹² poses a threat to the garnering of shareholder support in relation to environmental issues such as climate change.²¹³

Second, how effective a particular shareholder is in successfully engaging management and influencing outcomes depends on his/her perceived “salience”.²¹⁴ Given that managers “work in a world replete with conflicting signals”, determinations are made as to which shareholders and issues are considered and prioritised.²¹⁵ An empirical study found that the two most important factors contributing to the salience of a particular shareholder’s deemed legitimacy was the strength of its business case, and the values of the company managers.²¹⁶ This paper has already explored the business case for climate change which, if framed correctly, can aid the salience of a climate-conscious shareholder. As for the latter, however, “[a]n unsupportive individual in a key position can stop engagement in its tracks.”²¹⁷ Consequently, boards with little concern for mitigating climate change may be a significant barrier towards greater sustainability, well-intentioned as the shareholders may be. Studies have shown that this is particularly problematic in companies with entrenched boards, which “seem to pursue short-term objectives to the detriment of long-term value maximization”.²¹⁸ Even as the business case for mitigating climate change is becoming increasingly compelling, shareholders may face insurmountable difficulty in pivoting companies towards greater sustainability if board managers see little value in doing so.

Third, and most pertinently, the implicit reliance placed on shareholder primacy to direct companies to mitigate climate change is ultimately contingent on the survival of a ‘business case’ to avert climate change. However, so long as business sensibilities dictate how the issue of climate change is to be framed, mitigating it will be no more than an opportunity to improve efficiency and reduce costs.²¹⁹ Even if “doing well by doing good” has served as a useful aphorism, undertaking environmental initiatives becomes just one strategy to maximise profit – not only will boards be constricted from pursuing environmental agendas if they cannot be financially justified, they are tempted to pursue other strategies, even if they conflict with ESG goals, if those business objectives can be better met.²²⁰ As Min Yan states, “sometimes the clash of interests is inevitable, and if the business case is the guiding star under such a context, then the choice may be pursuing the immediate and perhaps lucrative business opportunities and comprising the CSR standards.”²²¹ Acting in the exclusive interests of shareholders is, as such, ultimately limited in its capacity to serve as a surrogate for environmental protection.

²¹² Katelouzou (n170), 583.

²¹³ Pfeifer (n39), 259.

²¹⁴ E James and M Gifford, ‘Effective Shareholder Engagement: The Factors that Contribute to Shareholder Salience’ (2010) *Journal of Business Ethics* 92:79-97.

²¹⁵ Cundill (n12), 609.

²¹⁶ James (n214), 92-97.

²¹⁷ Sjoström (n61), 8.

²¹⁸ Aggarwal (n123), 329.

²¹⁹ Sullivan (n2), 422.

²²⁰ Gadinis (n53), 22.

²²¹ Min Yan (n7), 81.

B. Adjusting shareholder interests to the long-term

In light of the foregoing, “the status quo is not and cannot be an alternative for humanity desiring to ensure viable ecosystems for future generations”.²²² Yet, with shareholder primacy being such an intractable corporate norm that it has acquired “almost axiomatic status”,²²³ how then can our current system be revamped that meaningfully challenges it without demanding its complete abolition?

I argue that the answer lies in readjusting what the interests of shareholders are. Specifically, even if “economic incentives” are inevitable, these need not be characterised as only serving “to exacerbate the narrow, short-term focus of the shareholder primacy drive”.²²⁴ Given the foregoing discussion, it may be somewhat surprising to find that the conventional view under corporate law has been that corporations should principally strive towards increasing “long-term shareholder value”.²²⁵

In this respect, it is germane to clarify that the economic incentives of shareholders, which form the basis of shareholder primacy, and the short-term nature of those incentives, are two related but ultimately distinct norms. The financial imperative is an intrinsic feature of capital markets; the “dominant logic... within which the field of investment operates”.²²⁶ Achieving profit has become the entire *raison d'être* for a company’s existence. Short-termism, on the other hand, is not quite so fundamental. It is not derived from any doctrinal attribute or idiosyncrasy of the market, but is arguably a function of a simple human trait: impatience. As Min Yan astutely observes:

“... shareholders are impatient. Such behavioral biases, i.e., present-biased preferences, determine that shareholders prefer to engage reward activities first and to delay immediate cost activities until later. Therefore, when immediate costs with delayed rewards (i.e., long-termism) are juxtaposed to immediate rewards with delayed costs (i.e., short-termism), the latter will be favored.”²²⁷

Nevertheless, as Richardson identifies, it is this norm of short-termism which poses the real danger, fueling a form of “hyper-capitalism” which has significantly contributed to the planetary ecological crisis.²²⁸ It is short-termism which prevents a sustainable business model from gaining traction,²²⁹ and which more properly warrants addressing.

Accepting that argument, the issue is then raised as to how the business world can be driven to regard short-termism as anathema to its interests. It is apposite to remember that the financial world is no stranger to the havoc short-termism has wrought, having already reared its ugly head during the 2008 financial crisis. Deemed as a “wake-up call”, this economic crisis demonstrated the dangers of “Wall Street’s short-term approach”,²³⁰ and sparked

²²² Sjäfjell (n108), 323.

²²³ Sjäfjell (n4), 84.

²²⁴ *Ibid.*

²²⁵ Hansmann (n55), 439; Ho (n15), 97.

²²⁶ Jacobsen (n150), 281.

²²⁷ Min Yan (n7), 59.

²²⁸ Richardson (n37), 570; Richardson (n8), 9.

²²⁹ Sneirson (n11), 85.

²³⁰ Gadinis (n53), 53.

changes in the financial system that took better account of risk management.²³¹ Such economic trends provide the fertile ground upon which the seeds of long-termism and sustainability can be planted within companies. As Millar et al opine, “the time is now right for the long-term constraints implied by science to be employed by the financial community in examining investments”.²³²

Indeed, a palpable movement is already seeking to remedy short-termism in the market. Apart from the UK Stewardship Code (discussed above), other voluntary codes, such as the Slow Money Principles, are encouraging shareholders to adopt investment practices that “slow... money down”.²³³ A renewed focus to promote a company’s ‘resilience’ has also inspired some businesses to look beyond short-term gain to anticipate risks, improve crisis management capabilities, and stay abreast of emerging ESG trends.²³⁴ While executives are still remunerated based on their performance, some companies are tying them to ESG goals rather than quarterly financial reports.²³⁵ Such initiatives are helping to curb the “myopic culture of business and reorient companies to long-term value.”²³⁶

Yet, even as the capitalist market is already witnessing fractures within the short-term tradition,²³⁷ deliberate measures to instill longer term time frames are still necessary. Many companies and asset owners still need convincing that focusing on the long-term or a wider stakeholder outlook is necessary not only to enhance their own financial performance,²³⁸ but to avoid irreparable climate disaster. Significantly, the psychological bias within each human mind to downplay long-term risks – known as “temporal myopia” – makes the idea that time can create value difficult to inculcate.²³⁹

While it is beyond the breadth of this paper to provide a consolidated list of solutions by which long-termism can be integrated into capitalist markets, it remains clear that governmental regulation is the cornerstone. Admittedly, some regulatory effort has been made to slow down the market, even if by an infinitesimal length of time – the IEX exchange based in New York incorporates a ‘speed bump’ feature that slows trade down by 350 microseconds.²⁴⁰ That said, no government has made any legislative requirement to compel institutional investors, or any other shareholder for that matter, to “follow a specific SRI-determined temporal horizon”.²⁴¹ Yet, what a government decides in subsidies, taxes, or information disclosure can steer a society towards sustainability, or away from it.²⁴² Law reform is thereby crucial for not only shareholders, but corporate managers and boards, to undertake “long-term stewardship of their business”.²⁴³ Mandating that companies compute

²³¹ Ho (n15), 89.

²³² Richard J Millar et al, ‘Principles to guide investment towards a stable climate’ (2018) *Nat. Clim. Change*, 4.

²³³ Slow Money, Principle 2 <<https://slowmoney.org/about/principles>> accessed 16 September 2020; Richardson (n37), 574.

²³⁴ Corporate Citizenship (n149).

²³⁵ Gadinis (n53), 18; Richardson (n41), 244.

²³⁶ Sjøfjell (n108), 328.

²³⁷ Alexander (n141).

²³⁸ Martindale (n161), 11.

²³⁹ Kim (n42); Richardson (n37), 568.

²⁴⁰ Nathaniel Popper, ‘IEX Group, Critical of Wall St., Gains Approval for Stock Exchange’ (*New York Times*, 17 June 2016) <<https://www.nytimes.com/2016/06/18/business/dealbook/iex-group-gains-approval-for-stock-exchange.html>> accessed 16 September 2020.

²⁴¹ Richardson (n37), 577.

²⁴² Anstey (n49).

²⁴³ Sjøfjell (n108), 327; Katelouzou (n170), 592.

and reveal longer term risks not only instils resilience in businesses. It is a gateway to “greater societal concerns over corporate compliance and increased stakeholder scrutiny”,²⁴⁴ leading to mutually enforcing pressures for companies to better realise a sustainable business model.

VI. CONCLUSION

Shareholder primacy has long drawn fire from academics for the reason why companies have failed in their stewardship of the environment – and justifiably so. However, the business world which has long treated nature with insouciance is now beginning to reckon with the damage it has wrought on the same. Ironically, shareholder primacy has facilitated this confrontation – shareholders are not only theoretically empowered to drive companies to address climate change, but have been empirically seen to do so. Indeed, the motivations of “responsible” shareholders and institutional investors are still very much defined by the shareholder primacy paradigm. Yet, shareholder interests are evolving to align with the climate agenda. This is because of two observable trends.

The first is the growing acceptance that climate change presents both financial risks and opportunities. Presenting a business case for climate change has provided “a sturdier basis to galvanise investors’ interest than amorphous pious talk”²⁴⁵ – financial prudence dictates that companies must reevaluate business assumptions and strategies,²⁴⁶ even if reducing their carbon footprint is the inadvertent byproduct rather than the central goal.²⁴⁷

The second is an evolving definition of what that “business case” is; one that is not shackled to short-term considerations. That business case has, in particular, been fastidiously promoted by institutional investors in the recent past – their extensive ownership and long-term financial horizons have allowed for a unique perspective to percolate into modern financial markets. Notably, the convergence of the ‘business case’ with climate related issues presents the thrilling prospect of a more expansive conceptualisation of the ‘business case’ being embraced. With underlying environmental factors potentially determining the success of a company more so than short-term metrics and indicators, shareholders are encouraged to think more broadly and with longer time frames in mind.

This does not mean that business-as-usual can continue undisturbed. Properly analysed, it is short-termism which now presents the main stumbling block in mitigating climate change and that deserves addressing. Instilling the long-term perspective within companies is the fundamental paradigm shift needed to overcome the tragedy of the horizon, and achieve a broader sense of sustainability within our capitalist world.

²⁴⁴ Matthias Damert and Rupert J Baumgartner, ‘External Pressures or Internal Governance – What Determines the Extent of Corporate Response to Climate Change?’ (2018) *Corporate Social Responsibility and Environmental Management* 25, 473-488, 475.

²⁴⁵ Richardson (n41), 242.

²⁴⁶ Nash (n135), 8.

²⁴⁷ Aggarwal (n123), 317.

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