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OPINION

Ethical and Responsible Investment

In the Vanguard: Fund giants urge CEOs to be 'Force for Good'

Passive managers link up to deliver checklist letter to change corporate behaviour

GILLIAN TETT - CITY

Bill McNabb, chair of Vanguard, will deliver a letter to CEOs urging them to report on their longer-term strategies and social goals © Bloomberg

American markets are spinning on a carousel. As fourth-quarter corporate earnings tumble out this week, analysts are digesting every digit, leaving share prices swinging.

But if Bill McNabb, chairman of Vanguard, has his way, this carousel may soon spin differently. This month, a group of influential asset managers and companies sporting the worthy label of CECP: The CEO Force f or Good, will assemble in New York.*

Mr McNabb and nine other asset managers plan to deliver a letter to chief executives that urges them to change their reporting style. Instead of focusing on the quarterly earnings dance, Mr McNabb's group — which manages $15tn in assets — wants chief executives to talk about long-term growth plans and risks, "with a minimum five-year trajectory", including their interactions with society.

And to "help" those CEO disclosures, they have produced a seven-point checklist that includes items such as data on "key risk factors and mega trends (such as climate change)" or how companies "manage their human capital requirements". Mr McNabb concludes: "For too long, companies have sacrificed long-term value creation to generate short-term results."

What should CEOs or investors make of this? A decade ago, they might have dismissed it as pious hogwash. After all, the vision of market capitalism that was taught in 20th-century business schools presumed that the primary — if not the only — goal of companies was to deliver returns to shareholders. Social metrics seemed merely to muddy this principle, at least in the eyes of men such as freemarket economist Milton Friedman.

But what Mr McNabb's letter shows is that Friedman's vision of capitalism is starting to look almost as passé as big shoulder pads. At last week's World Economic Forum meeting in Davos, CEOs were falling over themselves to talk about their "corporate social responsibility" departments.

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The finance industry was enthusiastically heralding the rise of "impact investing", which aims to produce worthy social goals and make returns. And last month, Larry Fink, the CEO of the $6tn BlackRock fund house — the world's largest asset manager and arch rival of Vanguard — released his own letter. This declared that "society is demanding that companies, both public and private, serve a social purpose" and "benefit all their stakeholders". Friedman might spin in his grave.

Quite why this is happening now, is a matter of some debate. A cynic might blame it on the fear of pitchforks: last month's Davos debates also revealed that the corporate and financial elites are terrified that rising levels of economic inequality and technological change will unleash social strife. A more generous interpretation is that the financial crisis of 2008 has sparked a genuine rethink among some CEOs.

A third, less noticed, factor is the impact of technology on the asset management world. The 20th century vision of capitalism presumed that investors could impose discipline on companies by selling shares or voting managers out if they underperformed. But today almost half of American equity funds sit in the hands of passive vehicles that use computers to make investment decisions, and give their votes to proxies, such as Institutional Shareholder Services and Glass Lewis.

This situation appals some free-market enthusiasts: Paul Singer, head of Elliott hedge fund, for example, likens passive investing to a gigantic "blob" that is now "devouring capitalism". The trend worries many regulators, too, some of whom are considering action. Given this, it is little wonder that entities such as BlackRock and Vanguard — the world's two biggest passive investment managers — want to jump into the capitalism debate.

Whether this will actually produce tangible change is unclear. BlackRock and Vanguard point out that they have already forced change at some companies: last year they helped to persuade ExxonMobil to start accounting for environmental risks. But their wider record is mixed, not least because they only have a few dozen staff pursuing these issues. And while Mr Fink says he plans to double the "engagement" team from 35 to 70, this is paltry.

But, if nothing else, Messrs McNabb's and Fink's missives show that the debate around capitalism is shifting. Maybe future historians will just view this as a luxury that flourishes in a bull market. I suspect, however, that there is a bigger cultural change afoot, as technology reshapes our ideas of how markets work. Either way, CEOs ignore this at their peril.

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** This article has been amended to reflect the rebranded name of the investor initiative*