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PERSPECTIVES ON THE LONG TERM

Building a Stronger Foundation for Tomorrow

The Long-Term Imperative for Financial Institutions

Finding innovative solutions to the challenges of the future will require stable capital markets and intermediaries.

by James P. Gorman

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The Long-Term Imperative for Financial Institutions

Finding innovative solutions to the challenges of the future will require stable capital markets and intermediaries.

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The strengths of well-functioning global capital markets include speed, scale, and efficiency in capital mobilization and allocation—attributes that, while positive, sometimes foster short-termism. Mobility and interconnectedness increase the speed of transacting and communicating but render it easier for decision makers to be caught in the welter of immediate concerns. Now, more than ever, corporate and financial leaders must clearly focus on the longer term in their strategic planning and investment decisions.

The following facts illustrate why this reorientation is vital: In 1950, the world's population was 2.5 billion; today, it exceeds 7 billion, and by 2050 it will have grown to more than 9 billion.[1] Much of this change will occur in major cities already grappling with issues created by dense population and high growth rates. Rapid urbanization, scarcity of clean water, inadequate nutrition, lack of housing, and periodic disease outbreak not only multiply the challenges to providing basic life necessities, they also affect economic growth and social prosperity.

These trends will alter the complexion of our economies and societies. To provide a prosperous, sustainable world for a larger population, we must develop markets less prone to structural upheaval and more capable of funding projects and companies that provide widespread, sustainable benefits and operate with respect for the planet. This means thinking today about how to plan for, manage, and adapt to tomorrow's realities, and requires a resilient financial infrastructure prepared to thrive under new conditions.

Many consider issues like climate change, poverty, and global health to be largely the purview of governments, philanthropies, and nonprofits. Each of those sectors no doubt plays a critical role in setting policy, providing essential services, and supporting innovative approaches to address market failures. The private sector, however, has a crucial role to play by deploying innovative technologies and developing new business models to meet changing social and economic circumstances. Companies that focus on these challenges will be best positioned for long-term growth; indeed, attempts to quantify the value of sustainable business opportunities yield estimates ranging from $3 trillion to $10 trillion annually by 2050, potentially 4.5 percent of the world's projected gross domestic product.[2] By harnessing the speed, scale, and efficiency of global capital markets, private sector-led solutions can proliferate and present the best chance of addressing challenges ahead. This concept is central to financial services.

For centuries, the prudent allocation and deployment of capital has been essential for economic growth and development. In the early 19th century, railroad and steel entrepreneurs built entire industries with the support of finance. In the century since, the development of deep, liquid public securities markets accelerated and democratized capital formation, enabling fresh business models that drove new industries. More recently, telecommunication pioneers and Internet visionaries have accessed markets to build companies that change how members of societies communicate, learn, and interact. The prospective challenge we now face is to channel capital to the innovators who will turn ideas into companies addressing our greatest social concerns, while also providing attractive risk-adjusted returns to capital providers. Private capital must be a part of building a sustainable world; in fact, without such capital, sustainability is unsustainable.

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Morgan Stanley is committed to building a long-term sustainable economy that yields social benefit. As a global financial institution, this means we must do several things.

First, we must ensure that we have a sustainable business model that is not only resilient but also contributes to a sound global financial system. This is a central tenet for any leader of a financial institution. Living up to this tenet demands a sound business, in all regards, from capital reserves to risk-management procedures, corporate culture, and a commitment to our communities and environment.

Within financial services, the past five years have been a journey; they have required difficult decisions to manage increasingly complex regulatory and operating environments. Thankfully, significant progress has been made in establishing institutional strength and stability. For example, at Morgan Stanley, liquidity at the time of the crisis was approximately $81 billion against an aggregate balance sheet of $1.2 trillion; it is now $190 billion against a balance sheet of $815 billion. Our leverage was 30 times and is now 12, while our capital has grown from $35 billion to $73 billion.[3] These were necessary changes.

The pre-crisis Morgan Stanley was a high-velocity, volatile collection of businesses that had fewer checks and balances. Today, the firm has become a deliberate, de-risked, balanced, and integrated enterprise focused on client advisory and execution rather than proprietary activity. We invested in businesses like wealth management, which provide ballast and predictability, while maintaining a leading investment bank and institutional securities franchise that offer first-class service to our clients. These measures, coupled with the actions taken by our regulators and industry peers, contribute to the improved resilience and soundness of the financial system.

Second, we must integrate a long-term perspective in evaluating investment opportunities for our firm and partner with clients that do the same. Information may cause markets to move rapidly, but prudent stewards of capital should also recognize long-term trends and their cumulative effects. We increasingly consider factors such as natural-resource scarcity and climate change in our daily processes of evaluation and review. Far from being just an exercise in risk mitigation, this represents a significant growth opportunity for those companies that successfully anticipate the products, strategies, and services that the future will demand.

For these reasons, we established the Morgan Stanley Institute for Sustainable Investing. Its mandate is to maximize capital's impact in supporting a more sustainable future by building scalable financial solutions that seek to deliver competitive financial returns, while promoting positive environmental and social impact. Through product innovation, thought leadership, and capacity-building programs that expand opportunities for sustainable investing, the Institute furthers capital's role in achieving sustainable economic growth.

Many of our clients actively think about sustainability as a key business driver as well. For example, when we help a company like Tesla with its initial public offering, the implications extend far beyond the immediate capital raised.[4] Tesla generated excitement among car enthusiasts by creating a fully electric vehicle with high performance standards and sleek design. Fueled by critical policy decisions, technological advances, and customer choice, a robust electric vehicle market can be financially rewarding while contributing to reducing carbon emissions and illustrating how to pair attractive, risk-adjusted returns with positive social and environmental outcomes.[5]

Similarly, the rapidly growing market for green bonds (which finance environmentally sustainable projects) demonstrates how financial-services firms can partner with clients to allocate capital resources to long-term instruments. In 2014, green bond issuance exceeded $30 billion, up from just $1 billion a few years ago.[6] Unilever, for example, partnered with our firm to issue its first-ever green bond last year; proceeds will help to reduce greenhouse-gas emissions, improve water usage and waste output, and increase energy efficiency at new and existing facilities. In the municipal sector, we supported the Commonwealth of Massachusetts in issuing the largest tax-exempt green bond, capital that will finance green infrastructure projects across the state. These are fundamental and laudable changes in clients' approach to finance.

Our individual clients also are eager to make long-term sustainability a central part of their portfolios. In fact, sustainable, responsible and impact investing assets now account for more than one out of every six dollars under professional management in the United States. In the last two years, US-based assets under these strategies have grown 76 percent, exceeding $6.5 trillion in assets under management.[7] To accommodate this demand, we launched our Investing with Impact platform, offering more than 120 vehicles that enable clients to align their values with their investments. Products focus on a variety of objectives, including clean energy, pure water resources, and affordable housing. To date, our clients have invested more than $4 billion through the platform, and we aim to channel $10 billion to it over the next few years. Interest will grow with the coming generational wealth transfer: younger generations, poised to inherit some $40 trillion of wealth,[8] are likely to seek products that pair economic returns with social and environmental benefits on a much larger scale.

Third, we must invest our time, talent, and resources to advance sustainable growth and prosperity for all. Institutions like Morgan Stanley can contribute meaningfully to sustainability by investing our time, talent, and resources. For example, we are collaborating with partners to provide economic opportunities to people with low and moderate incomes. Since 2010, we have invested more than $7 billion in high-impact programs such as equitable transit-oriented development and the Healthy Futures Fund, innovative programs that connect people in affordable housing with work and co-locate healthcare facilities near their homes. Such efforts create cohesive, vibrant communities that are the basis for economic well-being.

In addition, our Institute for Sustainable Investing helps develop the next generation of long-term-oriented business leaders. In partnership with INSEAD and the Kellogg School of Management at Northwestern University, we recently challenged teams of graduate students from around the world to demonstrate how investing can go hand-in-hand with positive social impact. Teams from 39 universities in ten countries responded with remarkable innovation and enthusiasm. The winning idea proposed transitioning ecologically damaged land to poplar forests that would decontaminate the soil and could be sold for commercial use. These efforts illustrate that combining human capital with global perspective and reach produces results that are tangible, effective, and attractive to all constituents.

The course of history has proven that rigorous analysis, underpinned by thoughtfulness, determination, and collaboration, can solve seemingly intractable problems. The social and environmental challenges posed by population growth and resource scarcity are significant and accelerating. Financial services will play a particularly vital role in providing the capital necessary for the private sector to generate creative and rewarding solutions to these problems. For these reasons, acting as a catalyst for sustainability is critical to our strategy and we stand with our clients, communities, and peers in our commitment to it. ■

[1] *World Population Prospects: The 2012 Revision*, United Nations Department of Economic and Social Affairs, Population Division, 2013, un.org.
[2] *Vision 2050: The New Agenda for Business*, World Business Council for Sustainable Development, 2010, wbcsd.org.
[3] The figures are as of August 31, 2007 (http://www.morganstanley.com/about/ir/shareholder/10q0807/MS_8-31-07_Form_10Q_Final.pdf) and September 30, 2014 (http://www.morganstanley.com/about/ir/shareholder/10q0914/10q0914.pdf?v=09302014), respectively.
[4] Sustainability accomplishments, Morgan Stanley, Global Sustainable Finance, morganstanley.com.
[5] Zachary Shahan, "The electric car revolution: Why electric cars are likely to dominate in the next decade," July 16, 2014, fix.com.
[6] *Q4 2014 Green Bonds Market Outlook*, Bloomberg New Energy Finance, 2014, bnef.com.
[7] "US sustainable, responsible, and impact investing assets grow 76 percent in two years," US SIF: The Forum for Sustainable and Responsible Investment, November 20, 2014, ussif.org.
[8] John J. Havens and Paul G. Schervish, "Why the $41 trillion wealth transfer estimate is still valid," Planned Giving Design Center, May 18, 2011, pgdc.com.