The Sustainability Board Report

COVID-19 Special Report
The Acceleration of Stakeholder Centricity

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The way COVID-19 reshapes the shareholder versus stakeholderism debate will have important implications for future crises. As the realities of other major systemic risks—such as climate change and increased social inequality—come to bear, understanding the evolving dynamics of this debate is in the best interests of society, especially corporate boards.

Executive Summary

Corporate governance is a system of checks and balances that a company designs to ensure that it fulfils its governing objective.

Articulation of the governing objective and subsequent design of the corporate governance systems are central to guiding corporate decision-making, especially in times of crisis.

Today there are two main camps that aim to define the idea of governing objective.

The first believes that the company's goal is to maximise shareholder value, with share price performance being the ultimate measure of a company's success. This view has been the most prevalent, particularly in common law countries.

The second argues that the company balance the view and interests of all its stakeholders. Also that the key to sustainable long-term growth is to increase the power and influence of all its primary stakeholders – the people who have "skin in the game" – for the company's long-term well-being. This less-held view is more common in countries with civil law.

A common critique of the second view —what we call 'stakeholderism'—is that, unlike

shareholder primacy, it fails to provide a decision-making compass for corporate leadership. Because firms comprise coalitions of stakeholders whose goals and values often conflict, stakeholderism cannot provide clarity on how to balance interests. This, it is argued, insulates managerial decisionmaking and results in reduced accountability and long-term value for the corporation. Another criticism is that stakeholderism is a publicrelations façade that gives companies a public front of social sensitivity while pursuing ulterior goals.

Despite these criticisms, stakeholderism has been on the rise. Since the 2008 crisis, there has been both a shift in mindset and—as seen by the rise of economic, social and governance (ESG) investing—in capital allocation. According to Edelman's most recent Trust Barometer survey¹, 87 percent of the public believes that stakeholders are more important to companies' longterm success than shareholders. Examples of stakeholderism's rise are easy to find, from the CEOs of America's largest companies committing to lead their companies for the benefit of all stakeholders to the 2020 World Economic Forum convening under the theme of stakeholder capitalism.

¹ The latest <u>Edelman Trust Barometer</u>, released in January, revealed that despite what was then a strong global economy and near full employment, trust in 2019 was at record lows among the mass population, with 56% of respondents globally believing that capitalism in its current form is doing more harm than good.

Executive Summary

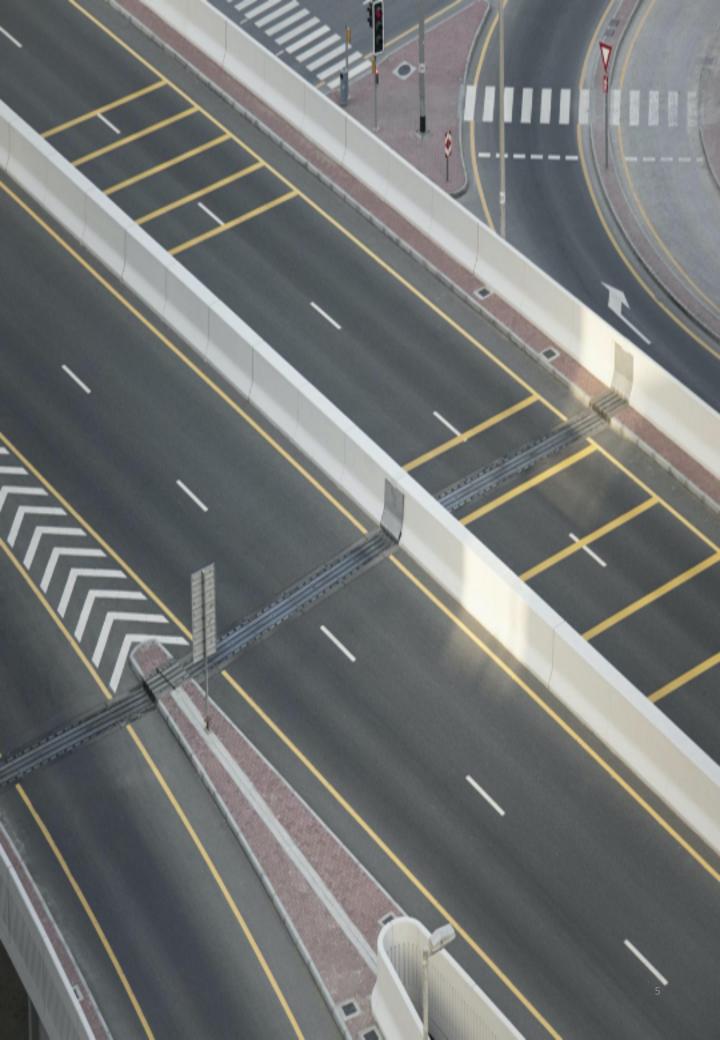
However, the COVID-19 pandemic is now putting unprecedented pressure on economies and societies. Companies are facing extraordinary financial and operational challenges. Importantly, the physical and financial health of a corporation and its stakeholders are more than ever intertwined. Instead of focusing on returns for owners and investors, companies are being forced to consider the interests of a variety of stakeholders - the employees, customers, suppliers and communities in which they operate.

The pandemic is not only a global tragedy, but an important opportunity to understand and influence change. Will the rise of stakeholderism be put under strain? Or will the interests of the constellation of stakeholders, and the balancing acts therein, come to the front of the corporate agenda?

This report showcases the disclosed efforts of the world's largest 100 publicly listed companies to balance their stakeholder interests. It finds that:

 COVID-19 has made all stakeholder groups in a corporate setting more visible. The extent of this shift depends on the specific industry and stakeholder group.

- Corporate commitments towards 'Community' and 'Suppliers' are the most and least visible, respectively. Despite the importance of 'Employees', especially during a pandemic, we see a less-than-expected disclosure of actions here. The prominence of 'Customers' depends largely on the company's industry.
- The nature of the shift has important implications. The consequences of a systemic recognition of stakeholder value will differ from a re-organization of individual stakeholder prominence in the stakeholder constellation of interests.
- A systemic increase in the recognition of stakeholder value is likely to lead to louder calls for a shift towards stakeholderism in the long term.
- A re-organization of stakeholder prominence within the stakeholder constellation of interests is likely to see a less transformative change and 'stickier' movement in the long term.



Methodology

In order to understand how companies are responding to the interests of their stakeholders during the COVID-19 pandemic, this report examines the specific measures taken by the world's 100 largest publicly listed companies. Examples of measures range from providing employees with guaranteed sick pay to shifting production lines to make anti-bacterial gels, and everything in between. To control for differences in media attention, we only use the information provided on each companies' corporate website.

The companies examined come from a range of industries. Financial services companies are particularly well represented (n¹=39), as are technology & communications (n=17) and extractives (n=12). Although almost all companies are exclusively based in North America (n=38), East Asia (n=29) and Europe (n=24), we assume that their size and global reach makes them suitably representative of the global corporate landscape. One limitation of this approach is that the data is partially skewed by East Asian (particularly Chinese) companies that usually have a poor history of disclosure.

We limit the scope of our analysis to the four principal stakeholders in each company's 'stakeholder constellation':



Because we are interested in the rise of stakeholderism as an alternative to shareholder primacy, our analysis excludes "shareholders" as a stakeholder group.

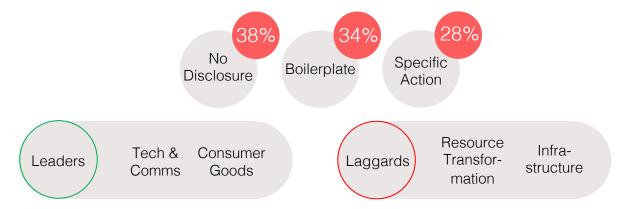
We then categorized disclosed corporate action based on the following metrics: 'no disclosure' (no efforts or none made public), 'boilerplate' (generic statements without evidence of extraordinary action) and 'specific action' (concrete, out of the ordinary action taken and disclosed).

n=sample size 6

Methodology

Noting the fast-moving contexts, we collected the data in early-May 2020 with the aim of painting a picture of the corporate landscape at the first peak of the pandemic in Western Europe and North America. Because we exclusively surveyed measures relating to COVID-19, our methodology provides a litmus test for stakeholderism at one moment in time. Our ambition is not to make conclusions based on detailed assessments of corporate action. Rather, by keeping the methodology simple and using a suitably large sample size, our aim is to identify trends and draw broad conclusions.

Findings: Employees



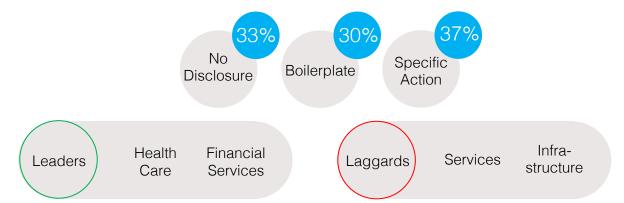
Employees are arguably the most important and, historically, well-organized stakeholder group. When employees suffer, so do all of those who are affected by the business. Unemployment rises, customers get fewer products or services and communities see drops in spending and rises in social service needs. We therefore expect that the interests and wellbeing of employees are a core part of the corporate responses to COVID-19.

Surprisingly, the data shows that 38 percent of all companies did not disclose a corporate response for employees. For the financial services, extractives, and transportation industries that number increases to more than 50 percent. Although it is expected that some companies choose to not disclose human resource measures during unsettled times, these figures are low. Thirty percent of the companies had 'boilerplate' responses, meaning they only reported alignment with governmental guidelines and regulations, such as social distancing and limiting numbers

numbers of staff in physical offices. Finally, only 28 percent took specific action. The consumer goods and health care companies scored highest with eighty percent.

Few, if any, companies have seen their workforces unaffected by the crisis. We therefore expected to see more evidence of measures to protect employee interests, especially in an era where the value of human capital is highly prized. The significant variation across industries suggests that employee groups hold a range of different positions in the stakeholder hierarchy. Given that, as a corporate stakeholder group, employees are comparatively well organized (for instance through labour unions), we expect that any gains in visibility are likely to be 'sticky' in the long term. For example, employees are likely to expect more flexible working arrangements from their employers. These gains may be offset by the reduced bargaining power of the group as a whole due to the high levels of unemployment.

Findings: Customers



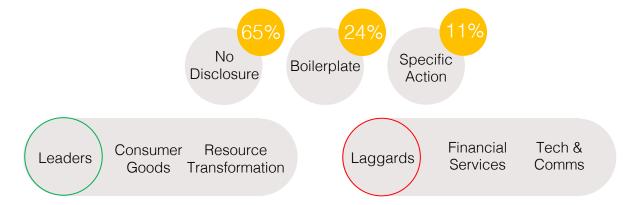
As global aggregate demand plummets, the importance of customers in supporting corporate survival takes centre-stage. Thus, we expect significant levels of disclosed efforts towards customers.

Overall, the data with regards to customers is mixed and varies significantly based on the industry. Similar to employees, 63 percent of companies did not disclose or had boilerplate disclosures. Only 37 percent had specifically formulated responses. Unsurprisingly, the data shows a clear correlation between the companies that sell directly to customers and those that do not. There was little disclosure from the extractives, infrastructure and transportation industries whereas consumer goods, health care and financial services had higher rates and generally provided comprehensive and detailed information (for instance on the possibilities of deferring mortgage payments).

For years, consensus between ESG experts has been that customers are watching ever more carefully the behaviour of the companies they buy from. Although a bank or insurance provider is not easily switched, digitalisation and technology are giving customers more choice, which intensifies competition. Moreover, after years of declining trust in business (most evident since the 2008 crisis)^{1,} companies are all too aware that customer perceptions must be catered for. Thus, it makes sense for the most customer-centric industries in our data set to be most likely to disclose efforts towards customers. That said, overall weak disclosure rates suggest that companies are not staking their reputation only on the measures taken for customers.

9

Findings: Suppliers

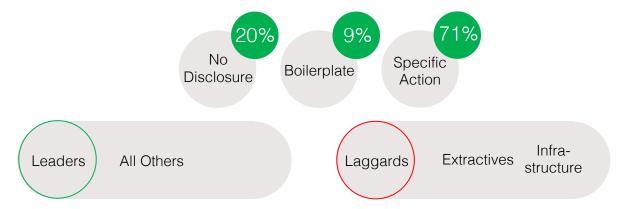


Edward Freeman, one of the first proponents of stakeholder theory, defined stakeholders as "those groups without whose support the organization would cease to exist". According to this definition, suppliers—without whom (almost) all companies would cease to survive—become very important stakeholders indeed, especially in times of crisis.

Yet, in terms of disclosed actions, suppliers were the most neglected stakeholder across all hundred companies assessed. Indeed, only 11 percent saw specifically formulated measures to address their needs with 65 percent seeing no disclosure at all. Interestingly, with the exception of financial services and technology & communications (which saw extremely low disclosure rates), there was little variation across industries.

The materiality of supplier management and the bilateral relationships companies have with their suppliers support these findings. Drawing from the Sustainability Accounting Standards Board (SASB) materiality map, we find that supplier relationships are "not likely to be material" for the majority of the industries assessed, particularly financial services and infrastructure. Materiality is higher for consumer goods and food & beverage companies, which constitute a smaller portion of the sample size. Moreover, companies are less likely to need to publish measures relating to suppliers on their public websites, as these will not be their primary interfaces for bilateral interaction. Overall, this suggests that the relatively low disclosure rates do not necessarily mean suppliers' interests are undervalued. Given the robust links between successful partnerships with suppliers and higher corporate performance, this is good news.

Findings: Community



As compared to the other stakeholder groups, communities are often the least involved in a company's day-to-day strategic decision making. When faced with a shrinking bottom line, we do not expect companies to prioritise measures for the community, especially if guided by the logic of shareholder primacy.

Yet, our data shows that communities had—by far—the most disclosed actions in their favour. Indeed, a striking 71 percent of companies assessed had specifically formulated actions with regards to the community. Although these varied in size, measures were often at a considerable financial and operational cost (for example, Johnson and Johnson committed \$300 million for frontline workers). Moreover, there was little variation across industries, with the highest rates of disclosed efforts being in consumer goods, health care and technology and communications. No disclosure and boilerplate responses represented only 20 and 9 percent, respectively.

We argue that two key reasons explain these figures. First, the community is different in that it comprises all the other stakeholder groups. How a company treats its communities therefore has multiplier effects across the stakeholder constellation, amplifying the primacy of the community group. Second, a community's perception is central to a company's reputation, which are often made or broken in times of crisis. To safeguard its reputation, it should be seen to be doing 'the right thing' for its community. This also perhaps explains why customers saw less-than-expected disclosed measures. Companies are staking their reputations on the community.

One clear conclusion from the data is that the COVID-19 pandemic has made all stakeholder groups more visible in the corporate landscape. Although it was not possible to assess the measures taken to respond to stakeholder interests prior to the pandemic, our data shows that, overall, 37 percent of all stakeholders saw specific corporate action to respond to their interests. This is unlikely to have been the case six months ago and is strong evidence to suggest that the pandemic has accelerated a shift away from a world of shareholder primacy to one of stakeholder pluralism.

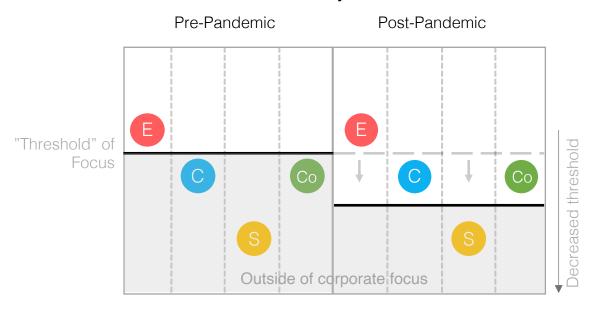
This aligns with evidence found elsewhere. Indeed, companies across all sectors have reconsidered their distributions to shareholders to preserve cash and support their stakeholders. Changes in capital allocation come not only from governments and regulators but also

supportive long-term investors and a new wave of executives driven by social or ethical ambitions. Given the need for investors to generate returns for their clients, their willingness to encourage companies to recognise stakeholder interests at the expense of short-term returns may be further evidence of a shift away from shareholder primacy.

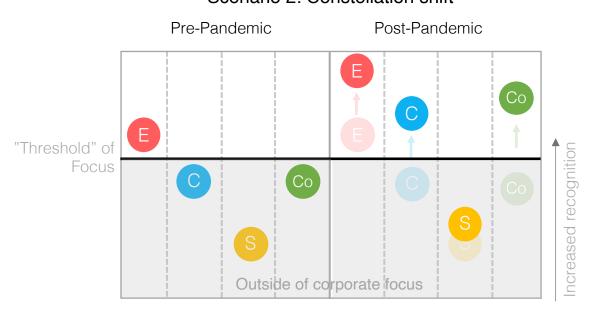
Looking forward, understanding the nature of that shift becomes important in making useful forecasts and recommendations. We envisage two possible scenarios. Scenario 1 is a 'systemic shift', whereby the corporate governance system expands its strategic focus to include the newly recognized interests of its stakeholders. Scenario 2 is a 'constellation shift'. whereby each stakeholder independently moves up or down the stakeholder hierarchy, with some rising above the threshold of corporate focus.

Figure 1: Systemic versus Constellation shift in response to COVID-19

Scenario 1: Systemic Shift



Scenario 2: Constellation shift



Legend: E= Employees, C= Customers, S= Suppliers, Co= Community

Figure 1 illustrates the different both scenarios. The first sees a decreased threshold for corporate focus (meaning increased recognition for all, besides suppliers). The second sees individual stakeholder movements (meaning increased recognition, subject to meeting the required threshold).

Demonstrating the most likely scenario without extensive empirical evidence is impossible. The reality is likely to be a combination of both. Yet, these scenarios are still important in helping us understand the long-term consequences of the increased visibility of stakeholders on the corporate landscape.

A systemic increase in the recognition of stakeholder value (Scenario 1) is likely to lead to louder calls for a shift towards stakeholderism. It signals an increased appreciation, from the perspective of the corporation, of the importance of stakeholders in achieving its long-term sustainability and value. Companies that embrace this shift are also creating stronger alliances with all stakeholders in society, such as the government and public at large. This, we believe, will help them better weather the COVID-19 pandemic – further galvanising the shift towards stakeholderism in the long run.

A re-organization of stakeholder prominence within the stakeholder constellation of interests (Scenario 2), on the other hand, is likely to see 'stickier' shifts within the constellation of interests.

This is because individual stakeholder groups are more likely to defend their own status quo and pay less attention to others.

Communities, for example, may expect corporations to behave in more socially responsible ways without necessarily extending that benevolence to suppliers. This is also likely to harden disparities across stakeholder groups and industries.

Do our findings reinforce or rebuke the criticisms of stakeholderism? The answer is mixed.

The first critique argues that stakeholderism does not provide an effective decision-making compass and that companies should simply maximize shareholder profits. The COVID-19 pandemic has broken this misconception by highlighting the way business depends on the collective support of society, especially its stakeholders. Moreover, despite the alluring simplicity of the shareholder model, blindly maximising shareholder value is inadequate in navigating crises of this complexity. Albeit imperfect, the stakeholder model allows companies to better appreciate and balance the interests its stakeholders – thereby maximising its long term value and sustainability.

The second critique is that stakeholderism is a public relations facade. Here, the data shows that employees and community—the two groups who carry the most significant 'weight' with regards to societal perception—are the stakeholders most catered to in public responses to COVID-19. This implies that, rather than equitably balancing the interests of all their stakeholders as a means of generating long-term value, companies are especially concerned about perception and reputation. One could conclude that some companies continue to pay lip service to stakeholderism while fundamentally maintaining a shortterm profit orientation.

Finally, COVID-19 offers a chance to reset and reshape the world in a more sustainable way. The way the pandemic re-shapes the shareholder versus stakeholderism debate has important implications for escalating crises such as climate change, mass biodiversity loss or even extreme social inequality – all of which are intrinsically linked to the interconnected global economy. Whether or not the corporate world embraces stakeholderism and uses its capabilities and resources in cooperation with all stakeholders to address the key issues of the future will determine the cohesiveness and sustainability of the world as we know it.



Author's Biographies





Frederik is the founder of The Sustainability Board Report (TSBR). He is an expert in international business development and management.

Since 2012 he has been working in HR consulting and organisational development. Besides running TSBR, he is managing the advisory and outsourcing practice in Asia Pacific for the world's largest provider of workforce solutions. He is passionate about shared value creation, purpose and leadership, and guiding through systemic change.

Frederik has lived in 4 countries and worked in numerous markets, most notably Europe and Asia.

Frederik is an advocate for lifelong learning, and holds a number of credentials from various top tier business schools and universities.





With a background in economics, international relations and human rights, Nicolas has gained high-level exposure to global health and development trends and challenges as part of high performing teams.

After studying at McGill University and the London School of Economics, he worked for four years in a variety of roles at the United Kingdom's Mission to the United Nations - reaching the rank of Health Attaché. Most of this time was working on global health issues for the Department for International Development's (DFID).

Nicolas now works as an independent consultant for various clients and is an MBA candidate at the IESE Business School.

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