Stakeholder Capitalism in Times of Crisis

June 2020

Introduction

Stakeholder Capitalism was in the spotlight when we wrote about it at the end of last year. The group of leading US companies represented by the Business Roundtable (**BRT**), in their statement on the purpose of a corporation in August 2019, had made a high-profile commitment to serve all stakeholders: customers, employees, suppliers, communities and the environment in addition to shareholders. Corporate purpose was set to be at the heart of the debate at the World Economic Forum in Davos (and climate change emerged as its major theme). At the time, some heralded the arrival of a new era of friendlier capitalism and others were sceptical. Since then, the global COVID-19 pandemic has affected everyone.

The term "stakeholder capitalism" is sometimes used in a broad sense to denote companies "doing good" generally, in contrast to companies "doing ill". A binary opposition is often created in which companies seen to be serving the interests of broader stakeholder groups are put in the former camp and those serving the interests of their shareholders in the latter. As we noted in our previous article on the topic, commitments of the type in the BRT statement are not legally binding on companies or directors. Consequently, perhaps, the challenges presented by COVID-19 could be framed as a "test" of stakeholder capitalism in times of crisis. The underlying reasoning is that it was easy to make commitments to stakeholders during an economic boom but leaner times must show that in reality shareholders come first and, if necessary, at the expense of stakeholders.

The post-COVID-19 economic climate for many is bleak but corporate purpose continues to be the subject of debate in this new world. At the beginning of this month, for example, over 200 CEOs of UK businesses wrote to the UK Government requesting that any recovery plan (including the terms of any financial support packages for companies) be aligned with the UK's legislated target of net zero carbon emissions by 2050. The real test for directors is how they react to stakeholder concerns and judge their company's response to the acute economic needs of all those they are dealing with when navigating the crisis for their company's own long-term future or, often, its short-term survival.

In this article we examine first how directors can look at their duties in a time of unprecedented crisis and whether stakeholder concerns must take a back seat, before considering what the COVID-19 crisis tells us about the meaning of "stakeholder capitalism" and the evolution of the purpose of a company.

Directors' duties and decisions

The primary duty of directors is to their shareholders. In Hong Kong, this is expressed in the Companies Ordinance as a duty to act in good faith for the benefit of the company as a whole. This is clarified in a Companies Registry Explanatory Note as a duty to act in the interests of all shareholders, present and future.

The corresponding duty in the UK under the Companies Act is for directors to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole (having regard to the impact of decisions on certain stakeholder groups). In the US, directors owe a duty of care to the corporation and its shareholders, tempered by the "business judgment rule", which broadly protects directors from shareholder claims where they have acted in good faith.

Given the overriding duty to shareholders, it may not be immediately obvious where other stakeholders can or should fit into the considerations of directors of companies under significant pressure from the COVID-19 crisis. There is a tendency to present the interests of these groups as mutually exclusive which is not, at least as a matter of law, accurate. In fact, in many jurisdictions, directors have broad discretion in reaching any decision to take into account wider stakeholder concerns provided they believe they are also observing their primary duty to shareholders.

Directors know well that the decisions they make and the considerations they take into account during this crisis will be the subject of intense public and political scrutiny, especially in relation to:

- any restructuring of the business
- changes to employee benefits and headcount
- the setting of executive pay
- the payment of dividends and any share buyback programme
- financial measures taken to survive the crisis

Stories of misjudged corporate behaviour spread quickly on social media. Directors will be aware that miscalculations on "stakeholder issues" may have a lasting impact on shareholder value because of associated reputational damage. In addition, many shareholders are under their own mandates or obligations to review other companies' acts and decisions in this area, in particular institutional shareholders with environmental, social and governance (**ESG**) mandates or which are under pressure from their own investors to meet ESG performance targets. BlackRock, for example, has stated that it expects investee companies to comply with its stewardship goals despite the impact of COVID-19. In a recent poll of UK Independent Financial Advisers undertaken by Federated Hermes, over three quarters of respondents believed investors would be motivated to divest from companies that have failed to support their employees or wider society through the crisis. In this sense, at least, wider stakeholder considerations and the duty to shareholders are not in opposition but very closely interrelated.

Given the potential gravity of decisions made in these unprecedented circumstances, enhancing communication between directors and all stakeholders will be a priority. In addition, large multi-national companies have to make very difficult decisions while the world's geo-political stability is rapidly weakening, with an increasing China-US polarisation.

Many Boards are giving urgent consideration to finding the right model for the representation of employees' views and interests in their decision-making processes in a way that is trusted and sustainable. Similarly, Boards are establishing new and more comprehensive lines of communication with shareholders, creditors, politicians, political and social commentators and other stakeholders, in order to keep them informed of policies and decisions and their underlying reasoning. These lines of communication are key when the company needs to present a cogent and robust story to investors in order to raise equity capital and, in some cases, solicit government support.

COVID-19 and the meaning of "stakeholder capitalism"

Countries around the world are starting to emerge from lockdown. Many of the problems that focussed minds on corporate purpose prior to this crisis such as climate change and income inequality will still be compelling as the dire economic impact of the crisis becomes clear. Other "stakeholder issues" such as the effect companies have on the environment and the treatment of non-employee workers employed through the supply chain are still as important to customers.

This is not to say that “stakeholder capitalism” necessitates companies deliberately reducing their profits or taking on a quasi-governmental role in society. Companies must be and continue to be the engine for economic growth. This is contingent on the long-term return of value to shareholders and directors’ legal duties in the management of companies continue to be aligned with this aim.

But a shift in or broadening of societal views on the purpose of a corporation is not antithetical to long-term shareholder value. It may, in practice, guide the directors tasked with delivering it. The values and perspectives of the people who buy from, work for, regulate and indeed own companies are still changing. Successful companies will adapt to these changes. In many jurisdictions including Hong Kong, the US and the UK, the law governing directors’ management of companies already permits them and, in a certain sense requires them, to make this happen.

Peter Brien
Partner
T +852 2901 7206
E peter.brien@slaughterandmay.com

Nicholas White
Associate
T +44 (0)20 7090 5076
E nicholas.white@slaughterandmay.com

© Slaughter and May 2020
This material is for general information only and is not intended to provide legal advice. For further information, please speak to your usual Slaughter and May contact.

Dated June 2020