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The increasingly urgent issue of social value

Companies strive to balance profitable growth and a positive contribution to society

In recent weeks, the coronavirus pandemic has brought the social dimension of business to the fore. The crisis is severely testing the claims of many companies that they are committed to the needs of numerous other stakeholder groups along with their primary obligations to their shareholders. Some observers are already asserting that the pandemic and the resulting expansion of the state's role in the economy have decisively shifted the debate on the conflicting objectives of shareholder value and stakeholder value in favour of the latter. This conclusion may be somewhat premature, pending further evidence. However, the crisis is making it apparent that public opinion is highly sensitive to corporate activities perceived as contrary to prevailing notions of fairness and morally appropriate conduct. The public outrage at the suspension of rent payments by major corporations after years of excellent profits is just one example. Another is the discussion on whether companies that have been using a substantial share of their excess liquidity for share buybacks should be eligible for state aid. In addition, public lenders are demanding that bailout measures be made contingent on a temporary suspension of dividends or the general elimination of management bonuses.

The overall picture suggests that many companies are taking a prudent and responsible approach to the coronavirus crisis. More than a few are trying to make a difference in addressing the crisis and to show that, in addition to pursuing their business objectives, they wish to contribute to the common good. As a result, the current crisis can be seen as the latest escalation of a debate that has been steadily gaining momentum over the past two years. At its heart is the question of whether it is time to de-emphasise or even eliminate shareholder value as the main driver of business decisions and to give more space to the demands of broader stakeholder groups. Important drivers of this discussion have included major global investors as BlackRock CEO Larry Fink, whose influential open letters have recently focused primarily on the climate crisis. This is emblematic of the aspiration of major investors to arrive at a clearer and more comprehensive formulation of what does – and what doesn't – qualify as a well-managed company today. The pressure exerted by such social movements as "Fridays for Future" has underscored the urgency of this debate, as have the waves of applause or backlash triggered by specific corporate decisions or political comments by CEOs.

One thing is clear: The discussion on sustainable capitalism is here to stay. Even before the coronavirus crisis, it was evident that this would lead to tensions and conflicting objectives that would be challenging for companies to navigate. If corporate conduct is no longer guided by the overriding question of what generates shareholder value, what other guidelines can or should be applied? Which criteria will inform decisions on which business opportunities are right for a company to pursue – and which are not? Will company representatives remain politically and ideologically neutral, or will they perhaps advocate certain principles or possibly even take sides on specific issues, as evidenced in the current Black Lives Matter movement?

If we look at the three dimensions most relevant to this debate – the environment, social and governance, or ESG for short – the area where the gap has narrowed the most between the expectations of shareholders and other external stakeholder groups would seem to be the environment. Many companies have long been active in this area with dedicated programs and fine-tuned systems of performance indicators. In response to the climate crisis, some have further tightened their benchmarks. However, the pressure on companies in this area is unlikely to subside, including among investors. In the coming years, it will be necessary for sustainability to be deeply integrated into value chains and business models. In the area of governance, executive compensation is still the most controversial issue.

Three theses for better orientation in a poorly defined field of action

From today's standpoint, the most difficult element of "ESG" to capture is the "S": the question of a company's "social value". It is a diffuse category, where the established fields of action include, among others, diversity and human rights. The demands imposed on companies in this area are steadily increasing, however, and frequently revolve around the question of what is seen as "fair" in social terms. In view of the growing polarisation of the public with regard to social issues, companies face greater risks than ever of stepping into a minefield.

Where can they find orientation in this area? Here are three theses on how they should reposition themselves on several levels.

First: Companies should establish guiding principles for their conduct as a reference framework in case of difficult decisions with ethical or social policy dimensions. This goes far beyond the question of whether a decision would be damaging to the company's reputation. One could call this a kind of "moral compass" for a company. There are two good reasons for this: First, companies should not rely on the existence of an implicit common understanding of what is right and wrong in a specific situation. On the contrary: Even within the company, there may be an enormous range of attitudes and opinions. Moreover, the top management – and specifically CEOs – should not be left alone with such decisions. This harbours the risk of off-the-cuff public comments by CEOs, for example in social media, tying the company to a position which, if identical or similar circumstances arise in the near future, may spark accusations of flip-flopping or hypocrisy. In such cases, damage to the CEO's personal reputation is almost inevitable. Nor should a company place its entire trust in the inner moral compass of a single individual, regardless of how reliable and consistent this person may appear.

Second: who speak of the growing demands of external stakeholder groups with regard to business activities should strive for a full understanding of these demands and how they are structured. With today's advanced data analytics methods, far more can be achieved in this regard than just a few years ago. This makes it possible to capture conversations, beliefs and attitudes on a much broader basis. Companies will soon discover that many of the positions and attitudes held by external stakeholders are highly heterogeneous and mutually contradictory. Prevailing opinions will be far from consistent or universal, whether on fundamental or specific issues. But the collected data will create a pool of information that will offer orientation amid the wide-ranging public debates and help to identify campaign mechanisms. They will provide the basis for spotting issues at an early stage, facilitating a more systematic approach to dealings with critical stakeholders.

Third: It will not be uncommon for issues impacting the social value of companies to be in conflict with the economic interests of the owners. In other words: It is possible that such issues will result in a company setting aside potential earnings opportunities or real profits in the short term. Consequently, it is only fair and reasonable

to give shareholders a voice when discussing such ethical codes for the company. And such discussions cannot be limited to conversations with the ESG experts of institutional investors. In the final analysis, we arrive at the point where a company's annual shareholders meeting could at least be permitted to debate the topic.

Grey areas will remain

However – and this is important – this ethical code of conduct should not limit a company's freedom to make decisions to the point where its entrepreneurial flexibility is too tightly restricted. Sufficient scope must be left for the management of ambiguity, because companies continually face situations where there is no easy solution or in which there are enormous trade-offs between one side and the other. There will always be grey areas. But those who think that such reflections are comparable to a walk in a swamp, where a company is sure to get stuck, are oversimplifying the matter. The days are gone when ESG led a niche existence in companies with little influence on the decision making and power centers. And they are not coming back. ESG will continue to play an increasingly prominent role in entrepreneurial activity. Conflicting objectives, with the potential to generate scandals and damage a company's value, will remain a fact of life. Companies should therefore create a platform to enable them to act and respond with greater resilience. They will have to show that they take the expectations of stakeholders seriously while retaining enough flexibility needed for entrepreneurial action and their credibility. Companies will have more big issues to face for which they should be prepared. Consequently, more than ever before, communicating with the capital markets will require skilful navigation through dynamically shifting stakeholder worlds.

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LUTZ GOLSCH
Senior Managing Director
Lutz.Golsch@fticonsulting.com

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