Part 3: New accountability mechanisms in the age of stakeholder capitalism
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This webinar explored a company’s social license to operate in this new era of ‘stakeholder capitalism’ promulgated by Covid-19 which elevates the importance of social factors as a key determinant to a company’s long-term financial health. We addressed the shift towards stakeholder capitalism and considered what is meant by company purpose.

ICGN is grateful to our Speakers as follows:

- Karin Halliday, Senior Manager, Corporate Governance, AMP Capital
- Claudia Kruse, MD Global Responsible Investment & Governance, APG AM
- Colin Mayor, Peter Moores Professor of Management Studies, Saïd Business School, University of Oxford
- Dr Ryohei Yanagi, Chief Financial Officer, Eisai Co.

What is company purpose?

Milton Friedman, 50 years ago, argued that corporations have no higher purpose than maximising profits for shareholders. This year at Davos, the World Economic Forum declared that shareholder capitalism was dead and has been replaced with stakeholder capitalism. Rather than a focus solely on generating profits for shareholders, company purpose has now been expanded to incorporate all stakeholder interests.

It was noted that companies are established to produce profitable solutions to address problems associated with people and the planet and that they should do so in a way that is commercially viable. Conversely, companies should not profit from producing problems for either people or the planet.

Defining corporate purpose is distinct from a mission statement which is about what a company does or a vision statement which is about what a company aspires to do. Purpose is about problems that companies are established to solve and how they set about achieving this.

It is important to identify the stakeholders that are critical to delivering a company’s purpose. The two notions of dependency on and dependency by other parties then defines which of the real key for companies. Prioritization should not be something which is at the expense of other stakeholders. It is more about understanding the priorities within stakeholders so that it is a win-win for all.

Purpose allows companies to clarify precisely what to prioritize. Purpose also helps companies clarify how they should be investing to promote their business going forward and deal with the challenges and opportunities presented by Covid 19. Purpose should be reflected in what companies do and should be linked to accountability and corporate governance.
Novo Nordisk’s approach to defining purpose

An example of a company which implements purpose well is the Danish pharmaceutical company, Novo Nordisk, which produces insulin that is used in the treatment of type-two diabetes. The company’s original purpose was about simply producing insulin but it has recognised that it’s purpose went beyond that. The company started working with doctors, hospitals and universities to identify the best forms of treatment of Type II diabetes. Then their purpose evolved to focus on helping people avoid getting Type II diabetes by working with governments to identify the changes in lifestyle.

You might think that this would undermine the fundamental model of producing the insulin but instead the business boomed. This is because it built strong relationships with doctors, hospitals, universities and so on who then trusted the business. In terms of business success, trust is one of the most important assets. This is a good example of a company that not only does well for its shareholders but also for its broader stakeholders.

Responsibility and accountability

It is critical that corporate boards take full responsibility for defining company purpose and oversee implementation, which should permeate throughout the organisation. Purpose should be connected directly with the company strategy, culture and values. It is not simply a marketing tool. It requires ownership by the board, the executive management and investors. Companies should measure their performance against their purpose.

Ultimately companies are accountable to their shareholders in terms of demonstrating that they are delivering on their purpose against a series of measurable metrics. The process should be audited and companies should report back to shareholders to demonstrate that they really are reflecting the interests of all of their stakeholders and putting their purpose ahead of profit as a way of delivering real benefits to the shareholders as well as to society.

APG approach to company purpose

APG manages the assets of two large public pension funds in the Netherlands and is an asset owner which invests on behalf of 4.5 million beneficiaries. They have very clear expectations that the pensions should be invested in a responsible way and contribute to a more sustainable world. This is manifested in policy objectives and in capital allocation.

Companies clearly cannot just serve shareholders. They need to understand their stakeholder expectations and align their strategy accordingly. This is a strong part of the dialogue that APG has with investee companies, including listed companies and companies in private markets. APG is also one of the largest real estate investors globally and therefore is not just focused on environmental issues but also social issues for example in relation to rental requirements.

Investors should concentrate on the contribution that they can make to the UN Sustainable Development Goals and allocate capital to help invest into solutions. A recent FT article stated that ‘as a as an investor, you are what you have in your portfolio’.
EU recommendations

The EU High-level Expert Group on Sustainable Finance provided recommendations to the EU Sustainable Finance Strategy, and there are two recommendations that are relevant to company purpose. One is about corporate governance and the duties of directors (corporate and financial institutions) where it is expected that directors take a stakeholder focus on long-term sustainability risks and opportunities and to address those appropriately. This approach should cascade throughout the organisation and impact on things like workforce composition and how incentives are structured and aligned over the long-term.

Another recommendation looked at the fit and proper test which is about whether board members have the right skill set and competencies to understand long-term sustainability risks which would imply a stakeholder focus. In the Netherlands, the Dutch central bank now requires an assessment of board members of financial institutions and this is a practice that could be emulated elsewhere.

Covid response bonds

In their engagement with companies, investors should look at whether the boards are equipped to balance the competing interests of stakeholders. There is a proliferation of 'Covid response bonds' which are bonds with proceeds that can really help address Covid challenges, for example in supporting SMEs or healthcare systems, etc.

This is a good example of collaboration between different kinds of stakeholders being development banks, companies and investors. This is core to a new form of stakeholder capitalism with very purposefully driven vehicles. They are still required to meet risk and return expectations because to deliver on pension promises but can also contribute towards solutions to the world’s challenges.

Purpose in a crisis environment

The significance of company purpose has intensified during the Covid crisis because it clarifies the difficult trade-offs companies need to make between their different stakeholders. For example, the need to cut costs which might disadvantage customers but retain employment, or the need to support society in response to COVID-19 which might conflict with distributing dividends which in turn impacts pensioners.

What many companies have come to realise over the last few months is the primacy of their employees as being vital to the viability of the business models. They recognise that they have to support their customers even if it has significant implications in terms of them having to cut their dividends or raise new equity issue. That in turn means that they have to invest in their employees going forward in terms of the skill sets that need to be made in future years.

What investors can also do if they are genuine long-term partners with companies it is to support companies in times of crisis, for example approving an equity issue that otherwise would not have been approved or expressing an understanding around a dividend reduction. Investors themselves must engage with different stakeholders to help inform decision-making and to avoid solely relying on company representation.