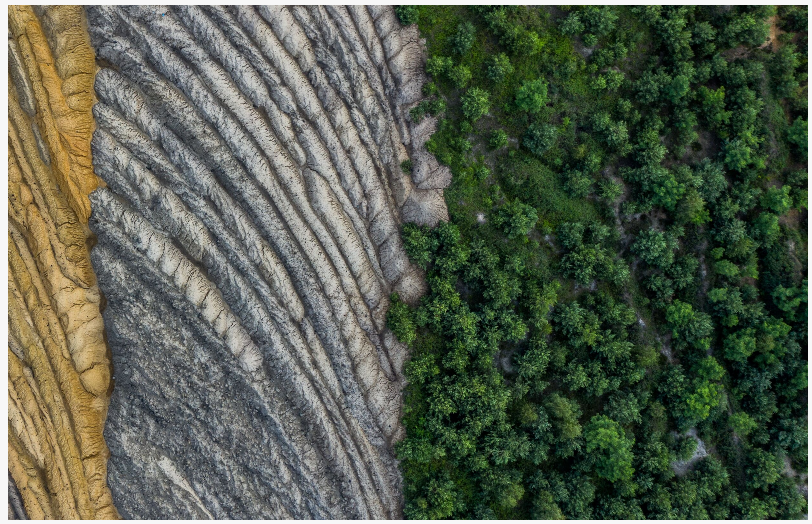
Stakeholder Capitalism is Growing

Despite the debate about whether "stakeholder capitalism" is really growing, data show boards increasingly reward executives for corporate social responsibility



LONDON, ONTARIO, CANADA, October 29, 2020 /EINPresswire.com/ -- Despite the debate about whether "stakeholder capitalism" is really growing, data show corporate boards increasingly reward executives for corporate social responsibility.

Though the Business Roundtable declared in 2019 that corporations should serve the needs of all stakeholders, there's fierce discussion over whether this shift to "stakeholder capitalism" is really happening.

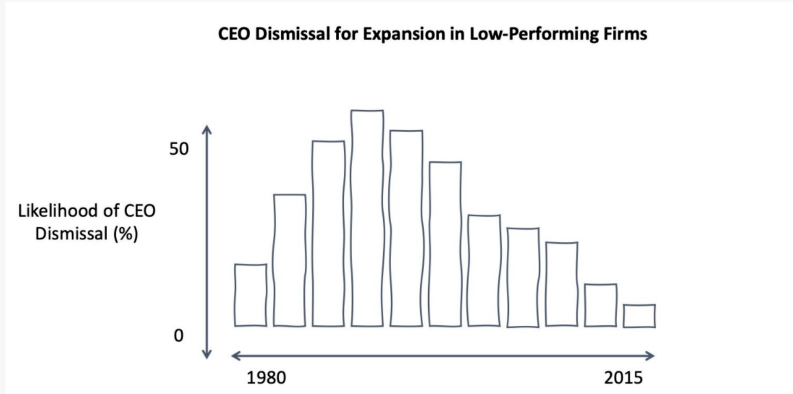
> Now, managers are increasingly expected to adopt CSR initiatives and pursue firm profitability in a way that considers a wide range of stakeholders and builds long-term value."
>
> *Network for Business Sustainability*

"Stakeholder capitalism" holds that managers ought to promote firm profitability in ways that meet the interests of multiple stakeholders, including but not limited to shareholders. It's seen as a replacement for the shareholder focus popularized by Milton Friedman.

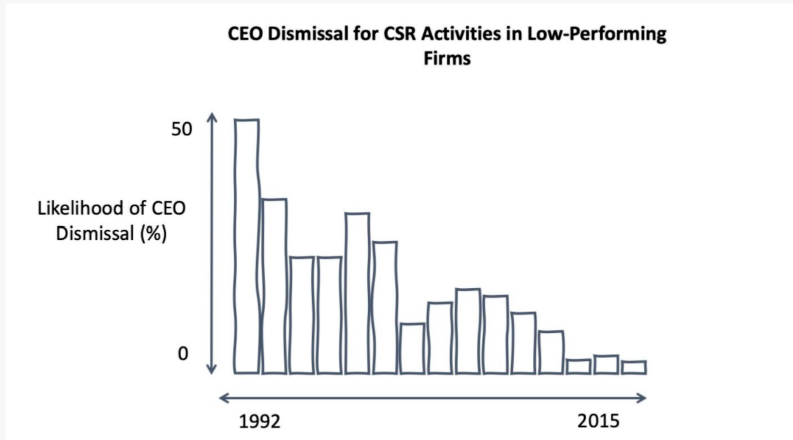
Some commentators say that the new emphasis on stakeholders is empty rhetoric and companies still focus solely on shareholder value. Others say that the world has finally broken away from Friedman's belief that "the only social responsibility of business is to increase its profits."

It's hard to know what businesses are actually doing, as observers tend to choose examples that support their point of view. Here, we provide a systematic analysis that has been years in the making. This study is the first research to demonstrate the corporations are moving towards a stakeholder orientation. We show that over time, a firm's commitment to social and environmental issues has become an important part of management evaluation.

CEO incentives show whether companies prioritize shareholders or stakeholders. In our research, we studied how corporate boards reward and punish CEOs. Board of directors and CEOs represent the highest level of corporate decisions about priorities. Boards influence CEO behaviour through rewards (e.g. pay packages) and penalties (e.g. dismissal).



CEO Dismissal for Expansion in Low-Performing Firms



CEO Dismissal for CSR Activities in Low-Performing Firms

If stakeholder capitalism is replacing shareholder capitalism, we should see boards rewarding CEOs for socially responsible actions and punishing them for a short-term focus on shareholder value. For our research, we analyzed data from 217 U.S. publicly traded manufacturing firms, those listed among the 100 largest firms by Fortune magazine from 1980 to 2015.[1]

We looked specifically at times when a firm was performing poorly financially (as measured by return on assets), and so boards likely examined CEO behaviour closely. How did boards judge CEOs for behaviour that prioritized:

- Short-term shareholder value. How did boards view downsizing the workforce (vs. expansion) and selling off unrelated businesses ("refocusing")?
- Corporate social responsibility (CSR). Did boards reward or penalize CEOs for strong CSR performance (as measured by evaluator KLD[2])?

Boards now want to see more socially responsible managers. Our research shows that since the early 2000s, U.S. corporations have moved from a model of capitalism that emphasizes shareholder value to a more stakeholder-oriented one.

- In the 1980s and 1990s, boards reacted to poor firm financial performance by:
- Rewarding CEOs for behavior targeting short-term shareholder value (downsizing and refocusing)
- penalizing CEOs for CSR activity.

For example, from 1990-1999, when firms performed poorly, CEOs had a 19.6% chance of being dismissed if they had downsized the firm, compared to a 46.4% chance if they had expanded the firm. Around the same period, CEOs faced a 10.5% chance of dismissal if the firm had low CSR scores, compared to 43.1% if the firm had high CSR scores.

In the 2000s and beyond: Boards reacted to poor financial performance by:
• penalizing CEOs for downsizing and refocusing and
• rewarding CEOs for CSR activity.

For example, from 2006-2015, when firms performed poorly, CEOs had a 17.1% chance of dismissal if they had downsized the company and only a 4.7% chance if they had expanded the company. Quite a reversal from two decades before! Similarly, CEOs had an 11.8% chance of being dismissed if their company had low CSR scores. When firms had high CSR scores, CEOs were relatively secure, with only a 1.9% chance of dismissal,

Boards, executives, and society are now run by new rules. In our research, we looked specifically at times when companies were experiencing poor performance: what kind of CEO behavior boards chose to reinforce then. That's because we believe that when firms are struggling, boards are more likely to consider whether CEOs are following generally accepted management practices.) The attached graphs show these

As a result, we think that boards' choice to reinforce stakeholder-friendly actions reflect their views of generally accepted management practice. In rewarding CEOs for prioritizing stakeholders, boards are saying that stakeholder capitalism is the new norm.

Note that the debate on stakeholder capitalism asks not only if capitalism has changed, but whether CEOs are doing enough. Our study cannot answer this question, but we can say that gains are happening.

Lessons for executives:

In the old days, CEOs who emphasized refocusing and downsizing to create shareholder value could avoid career penalties when the firm performed poorly. In more recent times, CEOs are increasingly being seen as creating value through their commitment to CSR initiatives.

The lesson extends to other levels of managers. When shareholder value ruled, managers could advance their careers by committing to management practices that simply lowered costs in the short term. Now, managers are increasingly expected to adopt CSR initiatives and pursue firm profitability in a way that considers a wide range of stakeholders and builds long-term value.

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[1] For a copy of the paper, please contact author Shoonchul Shin at sshin@ivey.ca.

[2] KLD (Kinder, Lyndenberg, and Domini & Co. Inc.) is an independent financial advisory firm that has provided CSR scores annually since 1991.

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