

Signalling sincerity in stakeholder capitalism



Milton Friedman versus Klaus Schwab – it was a battle between two world views. In 1970, Friedman wrote his seminal essay on the role of the firm effectively arguing that the “business of business is business” and that wider stakeholder considerations can be value-destructive. In 1973, Klaus Schwab’s Davos [Manifesto](#) argued that management must also serve employees and society, as a “trustee of the material universe for future generations”. While Friedman may have won the sprint, Schwab may be winning the marathon.

Today, almost five years into the fifteen-year trek towards the UN Sustainable Development Goals ([SDGs](#)), the role of business in delivering social and environmental outcomes is squarely in the spotlight. To the extent that a company can command and drive resources more impactfully than the sum of its individual stakeholders, the company must be accountable for more than shareholder returns.

In August 2019, the Business Roundtable, whose members are chief executives of major US companies, issued a path-breaking [declaration](#) on the purpose of a corporation: to serve *all* stakeholders, moving away from shareholder primacy.

According to a comprehensive [survey](#) of global CEOs released by the UN Global Compact and the consulting firm Accenture in September 2019, more than three-quarters of CEOs are now convinced that businesses *should* be making a greater contribution to social goals, and that this is crucial to building trust in their brands. However, there is a clear gap between statements of intent and actual action. Only 21% of CEOs believe that business is currently playing a critical role in contributing to SDGs. Small wonder that the convening objective of the World Economic [Forum](#) this year is to give concrete meaning to “stakeholder capitalism”.

To be fair, we have come a long way. [Impact](#) investing, green finance and tech-driven financial inclusion – now part of the speaking notes of CEOs in mainstream banks – were all on the fringes of the agenda just a few years ago. The number of [signatories](#) to the UN Principles for Responsible Investment continues to grow at an accelerating pace – representing half of all institutional investors and \$83 trillion of assets under management. More recently, the Principles for Responsible Banking were [launched](#) by 130 banks with an explicit link to both SDGs and the Paris Climate Agreement.

Separately, the CFA Institute, which amended its mission statement to include the phrase “for the ultimate benefit of society”, is helping to establish a standardised way for asset managers to report performance on their Environmental, Social and Governance ([ESG](#)) objectives. To take another example, there are now only three all-male boards amongst the top 350 companies in the UK compared to 151 in 2010. The target of [women](#) comprising a minimum of 30% of board members was achieved one year ahead of schedule.

Whichever way we look, either for reasons of social justice or for their enlightened self-interest, businesses and investors as a whole are moving in the right direction.

So, what is the problem?

The first factor to acknowledge is the weight of expectations. In a political climate where the system is characterised as either broken or rigged, both the bar of expectations and the cost of failure are high. With steeply rising expectations, what may have impressed last year may fail to do so this year.

On a backdrop of low trust, the tolerance for tokenism is that much lower. Self-congratulatory corporate communications must be backed by material, concrete action.

Businesses must realise that they are operating in a market of asymmetric information – the classic case of [Akerlof's lemons](#) – where the proverbial good guys must signal credibly to separate themselves from the bad guys. Credibility of signals – as opposed to vacuous virtue signalling – is determined by the cost of generating those signals. In some cases, transitions to sustainable business models might require near-term sacrifice in financial return. It is far better to acknowledge those trade-offs and help educate stakeholders than to gloss over them.

There are at least two areas in which genuine proponents of stakeholder capitalism can signal their separation from the impostors:

Proportionality

Stakeholder capitalism doesn't work if it remains the focus of a siloed, niche department while the rest of the firm dwarfs it in terms of resources and impact. Is \$20 million of impact investment cause for celebration when the company has revenues of \$20 billion and profits of \$5 billion? Just how excited should we get when a company with \$1 billion in income “spends” \$10 million to ensure equal pay for equal work amongst male and female employees? To be clear, these are positive developments that would've deserved applause a few years ago. Over time, if the size of steps remains disproportionately small, a company can stand accused of impact-washing, possibly providing a fig-leaf to other parts of the business.

Optionality

Stakeholder capitalism is undermined when firms do not pre-commit to measurable objectives. Well-meaning rhetoric can come across as platitudes if they are not consistent with pre-defined objectives. Which of the SDGs are you setting out to promote? How have you translated them in the context of your business? What actions do you intend to take? What outcomes do you expect? How do you propose to report back on progress? How will you consult stakeholders and how will you ensure that there are adequate governance structures in place?

On too many occasions, it appears as though companies want to keep all options open, floating from goal to goal, based on what is convenient or fashionable in a given quarter. Targets are either not set or they are set for a long-term horizon without intermediate milestones. While reporting is certainly not standardised across firms, they are often not standardised *within* the same firm across time. Random feel-good posts by executives on LinkedIn or gimmicky graphics on Instagram cannot be the yardstick of progress. Commitment to a consistent reporting template (that the company may self-design to suit its unique objectives) should remove the fluidity and selectivity that contaminate credibility.

To the extent that a business has signed up to the principles of stakeholder capitalism, there must be an explicit role of the [board](#) and independent directors in the governance of implementation. Finally, the coordination challenge and prisoners' dilemma faced by individual firms in volatile, competitive markets should not be underestimated. This will require collaborative leadership of the highest order. To quote Orit Gadiesh of [Bain & Company](#), “Leadership teams need to create forward-leaning agendas, together with other companies in the same industries”. That leaning must now be harder and faster than ever before.



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