EVOLVING DEBATE ON STAKEHOLDER CAPITALISM

—DEVELOPMENTS IN EUROPE AND AMERICA ATTRACTING ATTENTION—

Takenori Shimada
General Planning Dept., Global Economic & Political Studies Div.
Mitsui & Co. Global Strategic Studies Institute

SUMMARY

- As the Covid-19 crisis reveals numerous economic and social issues such as inequality, companies are being required to practice stakeholder capitalism. In fact, although many companies are taking active measures, expectations from society are surpassing even these.

- There is a possibility that in the United States, the arrival of President Biden, who criticized the shareholder primacy during the election campaign, and in the EU, a rethinking of short-termism and examination of legislation on supply chain due diligence for human rights and the environment, respectively, may accelerate stakeholder capitalism.

- Japanese companies also need to take the initiative and make a fitting response to these international developments.

1. COVID-19 CRISIS ACCELERATES STAKEHOLDER CAPITALISM

The spread of Covid-19 not only has threatened people's lives and health, but also has worsened economic disparities, and moreover has brought to light such problems as health disparities (access to medical care, the potential of remote work, availability of paid sick leave, etc.) and the vulnerability of supply chains that are too dependent on specific countries. Taking the trend in the US unemployment rate as an example, the fourth quarter of 2020 (average) recorded a deterioration by as many as 3 points from the previous year. Judging from the fact that the unemployment rate is rising more rapidly for the younger than for the middle-aged and older segments, for people with basic educational backgrounds rather than the highly educated, and for minorities more than whites, widespread economic disparities have been factors in accelerating tendencies toward social division (Figure 1).

Figure 1. Unemployment Rate Trend (the US, seasonally adjusted, %)

	2019-4Q	2020-4Q	*Range of change*
Overall			
General	3.6	6.7	*+3.1pt*
By age group			
20-24 years old	6.6	10.9	*+4.3pt*
25-34 years old	3.7	7.0	*+3.3pt*
35-44 years old	2.8	5.6	*+2.8pt*
45-54 years old	2.6	5.6	*+3.0pt*
55 years old and up	2.6	5.8	*+3.2pt*

	2019-4Q	2020-4Q	*Range of change*
By educational attainment			
Less than a high school diploma	5.5	9.6	*+4.1pt*
High school graduates, no college	3.7	7.9	*+4.2pt*
Some college or associate degree	2.9	6.4	*+3.5pt*
Bachelor's degree and higher	2.0	4.1	*+2.1pt*
By race			
White	3.2	6.0	*+2.8pt*
Black or African American	5.8	10.3	*+4.5pt*
Asian	2.7	6.7	*+4.0pt*
Hispanic or Latino ethnicity	4.2	8.9	*+4.7pt*

Source: prepared by Mitsui & Co. Global Strategic Studies Institute based on the materials by The Bureau of Labor Statistics

Some of the problems are the result of companies' excessive pursuit of economic rationality by such means as globalization under the shareholder primacy. For this reason, companies are now being required not only to contribute to overcoming the crisis at hand but also to practice stakeholder capitalism with a commitment to all stakeholders such as employees and society and not just to shareholders, in order to make the post-Covid-19 society inclusive and sustainable.

Stakeholder capitalism was attracting attention even before the Covid-19 crisis, and momentum has increased[1]. In August 2019, the BRT (Business Roundtable), a large corporate management organization in the United States, announced in the "Statement on the Purpose of a Corporation (the "Statement")"[2] that they would change the commitments to all stakeholders, including customers, employees, business partners, and communities (including the environment), from the shareholder-first principle, which they had been advocating since 1997. Furthermore, in December 2019, the WEF (World Economic Forum) published the "Davos Manifesto 2020" which states that companies should serve all stakeholders, not just shareholders.

In 'BUSINESS ROUNDTABLE CEOS ARE RESPONDING TO COVID-19'[3] , a document that summarizes the Covid-19 response of member companies, BRT reaffirms the content of the above-mentioned Statement, as it has been continuing to commit to all stakeholders, and emphasizes consideration for stakeholders, stating that the health and safety of employees and consumers is a top priority. As more specific corporate actions, BRT introduced development of new test kits and treatments, provided facilities for testing, procured and manufactured vital medical equipment, and provided expertise, funding and supplies.

In fact, some studies show that companies that signed the BRT "Statement" have better records in supporting stakeholders than others[4]. However, in Edelman's Trust Barometer Survey 2020[5] (covering 11 countries around the world, primarily in Europe and the United States), evaluation of business owners' Covid-19 response was the lowest of all subjects, also including politicians and journalists. Judging also from the fact that 65% of respondents said that CEOs should take the lead in pandemic responses without waiting for government instructions and requests, in the relevant survey, it seems possible to consider that although companies have achieved certain results with their pandemic responses, including stakeholder support, the world's expectations for them are higher than this, and they are still not highly rated.

2. THE DEVELOPMENTS PARTICULAR TO EUROPE AND TO THE UNITED STATES MAY ACCELERATE STAKEHOLDER CAPITALISM

United States: Changes brought about by the arrival of President Biden

There are developments in Europe and the United States to further advance stakeholder capitalism. First, in the United States, the arrival of President Biden is expected to have a major impact on companies.

As President Biden points out on his website, "The idea the only responsibility a corporation has is with shareholders is an absolute farce. They have a responsibility to their workers, their community; to their country. This is not a new or radical idea, but a principle that supported the founding of the country." In addition, when looking at President Biden's campaign speeches and policy agenda, other than the well-known focus on climate change and environmental issues, there are many policies that are in line with the idea of stakeholder capitalism[6]; for example, he states that he will provide workers with higher salaries, better benefits, and a fair and safe workplace, and he will require large companies and wealthy individuals to bear a fair share of the burden; he supports labor unions, and points out that the management of the company needs diversity in the aspects of gender, race, etc. It is highly likely that President Biden will take concrete actions to resolve the economic disparities among young people and minorities who supported him in the election campaign during

[1] For details, refer to Mitsui & Co. Global Strategic Studies Institute "Capitalism Under Pressure to Transform Qualitatively -Has the Time Come for a Shift to Stakeholder Capitalism?" (April 2020).
https://www.mitsui.com/mgssi/en/report/detail/__icsFiles/afieldfile/2020/06/15/2004d_shimada_e.pdf
[2] https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationOctober2020.pdf
[3] https://www.businessroundtable.org/covid-19
[4] https://justcapital.com/reports/how-business-roundtable-companies-have-responded-to-six-critical-stakeholder-issues-during-the-covid-19-pandemic/
[5] https://www.edelman.com/sites/g/files/aatuss191/files/2020-05/2020%20Edelman%20Trust%20Barometer%20Spring%20Update.pdf
[6] https://joebiden.com/build-back-better/
https://joebiden.com/2020/07/09/the-future-must-be-made-in-america-by-all-of-america/
https://joebiden.com/empowerworkers/#

the state of the Covid-19 crisis. This is in contrast with the era of President Trump, when such economic policies as tax cuts were sometimes criticized for being preferential treatment for the rich and there was a reluctance to discuss environmental and social issues such as withdrawal from the Paris Agreement and also strict immigration policies.

It is also noteworthy that a working group (WG) on corporate governance has been formed with Senator Warren who contested Mr. Biden in the Democratic primary, as a member. The purpose of the WG is to propose bills that will lead to fundamental reforms in corporate governance. Considering the fact that Senator Warren has argued that management should consider all stakeholders, not just shareholders, and has proposed the Accountable Capitalism Act, which calls for 40% of boards to be elected by employees, etc., it is expected that proposals from the WG will be for correcting the shareholder primacy and demanding consideration for stakeholders. With the high degree of visibility of Senator Warren, it can be said that there is a good chance that she will have an impact, through the activities and recommendations of the WG, on the administration of Congress and the public opinion making. The sense of distance President Biden creates from the WG will be worth noting.

As President Biden is reportedly negative about encouraging changes in corporate behavior through legislation[7], it is unlikely that US companies will uniformly shift to management with emphasis on stakeholders. However, the changes mentioned above will solidly buttress the efforts of companies that are active in stakeholder capitalism. As a result, the gap from companies that are reluctant to be active is expected to widen.

EU: Legislative developments related to corporate governance

The EU is currently in the process of reforming corporate governance to shift corporate management from pursuing short-term profits to governance that respects stakeholders, especially the environment and society. The European Commission has been soliciting public comment as to “Sustainable corporate governance“[8] (deadline: February 8, 2021).

Public comment is broadly divided into (1) those that relate to sustainable corporate governance, obligations of management, etc. and (2) those that relate to supply chain due diligence, and there are questions on a wide range of items (Figure 2). Particularly, we should turn our attention to the point that the introduction at the EU level of a legal framework for supply chain due diligence has been identified as an option.

Figure 2. Primary questions for public comment on the EU’s sustainable corporate governance

(1) On sustainable corporate governance and obligations of management, etc.
Should management consider the interests of all stakeholders in balance, rather than focusing solely on the short-term interests of shareholders?
Should this point be clearly stated in the law as a management responsibility?

(2) On supply chain due diligence
Should creating a EU-level legal framework be considered for supply chain due diligence with regard to human rights and the environment?
Industry sectors and themes that should be subject to due diligence
Handling of small and medium-sized companies
Handling of companies incorporated in third countries that are active in the EU
What should be the accountability enforcement mechanism when compulsory due diligence is introduced (judicial enforcement, government supervision, etc.)

Source: Source: prepared by Mitsui & Co. Global Strategic Studies Institute based on materials from the European Commission

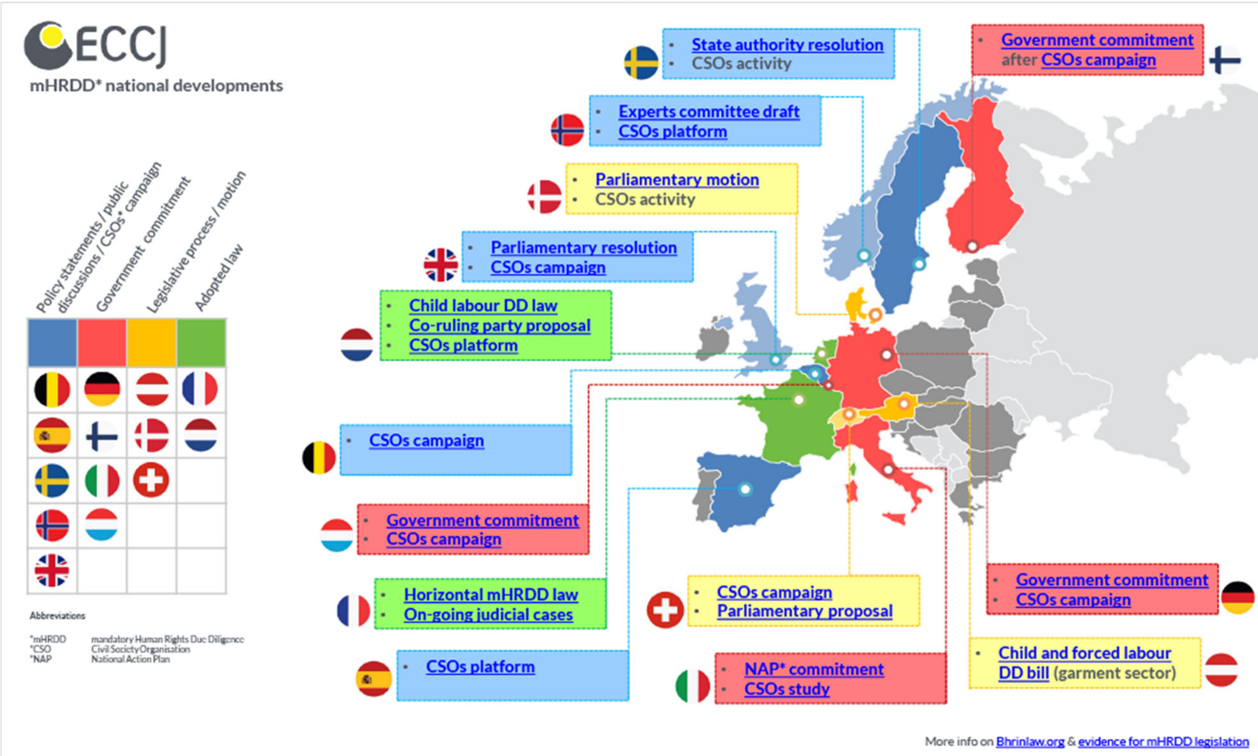
Since the publication of the United Nations Guiding Principles on Business and Human Rights (the “Guiding Principles”) in 2011, international awareness of this field has increased. However, in a survey (The study on due diligence requirements)[9] released by the EU prior to this public comment, it is pointed out that only 37% of

[7] https://www.wsj.com/articles/duponts-up-and-down-history-shaped-bidens-views-on-business-11606157282
[8] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation
[9] https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en

responding companies are conducting due diligence on both the aspects of human rights and the environment, and that the majority of these only conducted due diligence up to Tier 1 level. The conclusion is that it is not possible to carry out sufficient measures in the current situation that revolves around voluntary efforts under soft laws such as the Guiding Principles. EU regards this as the basis for drafting legislation.

European companies have welcomed these legislative moves. According to the survey mentioned above, 75% of responding companies said EU-level legislation would benefit them. On supply chain due diligence, there are some gaps in the status of handling at individual companies, as some countries such as France and the Netherlands have taken the lead in legislation, and Germany and other countries are also looking to it (Figure 3). If EU-level legislation is achieved, the handling costs are expected to be reduced due to unification of regulations in the EU area. Also, the points that this will result in improved legal stability, unification of the conditions of competition, protection during lawsuits and grounds for requesting third-party companies to cooperate in due diligence are also well received.

Figure 3. Status of examination of mandatory due diligence in Europe



Source: ECCJ

Already at the industry level, there is the precedent in that European companies' supply chain due diligence efforts have spread globally. The Together for Sustainability initiative, which was founded in 2011 by six European chemical companies, is working on global standardization of supplier assessments and audits to improve supply chain sustainability in the chemical industry. It has expanded to the point where 29 major chemical companies, including American firms, have participated[10]. If a unified regional law on supply chain due diligence goes into effect (although the details of the law such as the scope of coverage will need to be worked out) in the vast EU market, the impact is expected to be massive, coupled with the positive attitude of these European companies.

The EU's corporate governance reforms are positioned as part of the sustainable finance initiative[11]. “Fostering sustainable corporate governance and attenuating short-termism in capital markets” is stated as item 10 of the

[10] https://tfs-initiative.com/

[11] Under the Paris Agreement, the EU has pledged to reduce greenhouse gas emissions by 2030 by 40% compared to 1990. It is estimated that additional investment of 180 billion € will be required annually to achieve these goals, but since public funds alone cannot cover this, various policies have been moved forward such as establishing a “taxonomy,” which summarizes the classification standards for sustainable economic activities with the aim of obtaining private funds.

Sustainable Finance Action Plan announced in 2018, since the tendency to focus on short-term returns in the financial markets could be an obstacle to sustainable finance. The EU points out the importance of changing corporate governance to sustainable governance in the European Green Deal, which is positioned as a growth strategy, and also in the policy documents on the "next-generation EU" recovery plan from the Covid-19 crisis. This shows that the priority of this is very high for the EU. It will be necessary to keep an eye on developments in the EU.

3. THE IMPACT ON JAPANESE COMPANIES MAY BE GREATER

Capitalism is often broadly divided into (1) the Anglo-Saxon type, which is characterized by shareholder primacy and centers on the United States and the United Kingdom, and (2) the type that includes the concept of stakeholder capitalism, which is found in Japan or on the continent of Europe. In the 2000s, as globalization accelerated, the Anglo-Saxon type became ascendant, and trend convergence of capitalism into the Anglo-Saxon type was seen; however, recently this trend has been reversing. That is, the United States is attempting to shift from the Anglo-Saxon type, and meanwhile the EU is attempting to reinforce the characteristics of stakeholder capitalism that the continental European-type capitalism has followed.

The fact that both the US and EU are moving toward stakeholder capitalism could be favorable for Japanese capitalism, in the sense of a common direction, but this does not mean maintaining the status quo is permissible. Taking for example supply chain due diligence, which has been the focus of attention in the EU developments, in Japan as well the government formulated Japan's National Action Plan on Business and Human Rights (2020-2025) in October 2020. However, this plan merely states that the govenment expects the process of human rights due diligence will be introduced and there will be dialogue with stakeholders, including those in the supply chain. There is a good likelihood that the EU developments will go far beyond that. Japanese companies need to keep pace with foreign companies in areas that attract particular notice, such as the environment and human rights, while following developments overseas.

In addition, intensification of information disclosure to and of dialogue with stakeholders are also challenges for Japanese companies. The relationships between companies and stakeholders are varied, and there is no uniform standard for information disclosure and no evaluation system for efforts by companies for stakeholders. For this reason, in order for companies to obtain a proper evaluation of their efforts, it is essential to reinforce information disclosure to and dialogue with stakeholders and call attention to this. What's more, in this situation where expectations for corporate contributions are becoming more demanding among growing concern about social issues such as economic disparities and environmental issues, intensification of dialogue with stakeholders and collaboration with them to resolve social issues could be indispensable for companies.

As Western companies are expected to accelerate their efforts toward stakeholder capitalism, if Japanese companies delay in responding to the above-stated activities, the result may be increased reputation risk and valuation decline in financial markets. Japanese companies need to accelerate their response to stakeholder capitalism while paying close attention to overseas developments.