TOMORROW'S CHALLENGES

COVID-19 IS TURNING THE TABLES ON SHORT-TERM SHAREHOLDERS

By Paul Strebel, Emeritus Professor of Governance and Strategy

Chemin de Bellerive 23
PO Box 915,
CH-1001 Lausanne
Switzerland

Tel: +41 21 618 01 11
Fax: +41 21 618 07 07
info@imd.org
www.imd.org

In the presence of COVID-19, more companies are realizing that they have to take a longer-term view. They are turning away from short-term shareholders towards their value creators, ranging from employees, customers and suppliers to partners and venture capitalists; those who drive win-win initiatives creating value both for the company and themselves.

To survive COVID-19 and the hiatus in business activity it has marked, companies must ignore the interests of short-term shareholders and preserve liquidity. They must also cut back on dividends and buybacks for the longer run. Why?

Because their survival and future cashflows depend not on shareholders, but on retaining and enhancing their customer base and the productivity of their employees. This provides the basis for survival and future value creation based on top-line growth (customers) and/or bottom-line profitability (employee productivity).

The list of companies on both sides of the Atlantic cutting back on dividends and buybacks is growing in industries like airlines, retail, hospitality, energy, automobile and even chip manufacturers. Some of this is driven by the need to qualify for government stimulus packages. For example, companies given equity injections by EU member states will not be allowed to make shareholder payouts or grant executive bonuses.

By contrast, most of IMD's corporate clients are not cancelling their executive development programs and top management workshops but instead are moving almost everything online, including what was previously face-to-face and experiential leadership development into virtual meeting places and discovery expeditions.

COVID-19 is creating a reset in corporate priorities. With further crises a possibility, higher short-term C-suite and shareholder cash compensation will be difficult to sustain. After COVID-19 passes, the new corporate champions will be those not only with a strong business model, but with a cash flow distribution policy that supports (a) their survival, (b) value-creating stakeholders and (c) long-term shareholder value.

Shareholder and most stakeholder interests coincide in the long run because the cost of short-changing stakeholders becomes increasingly apparent in their negative impact on the company's shareholder value. Take BP's risky deep-sea drilling in pursuit of greater short-term profits; it precipitated the Deep-Water Horizon explosion, and the subsequent pollution of the Gulf of Mexico. This ultimately cost BP shareholders $65 billion in penalties and clean-up costs.

The winners will be firms that are using today's cashflow to develop win-win initiatives with as many stakeholders as possible. This involves articulating a broader corporate purpose beyond financial returns. Tom Malnight, Professor of Strategy and General Management at IMD, has documented how this has been done in diverse industries and geographies: among others, the US firm Mars Petcare in the realm of animal health; the Finnish oil-refining firm Neste in the area of renewable fuels from waste feedstock; and Mahindra Finance - India's largest rural non-banking financial company.

Getting stakeholders to participate in creating more value requires rewarding them more. And this means doing so up to the point where no additional long-term value is created for the firm. Short-term shareholders may not like it, but it’s essential to get stakeholders to commit more to the firm than required by their basic market-based contract.

Not surprisingly, the reset is threatened by moral hazard.

Corporate lobbying is working overtime to avoid changing company priorities by capturing as much of the government stimuli as possible. Big banks are set to benefit hugely from acting as the conduit for the funds being pumped into economies. Large private equity groups are lobbying to access the funds ear-marked for smaller business rather than supporting the companies in their portfolios themselves.

The more they and others succeed, the more they will persist with unproductive cash distributions to short-term shareholders.

The COVID-19 reset is creating a sharper distinction between those chasing short-term financial wealth by all means possible and those pursuing long-term shareholder value benefitting other stakeholders and societal needs. For the health of the western liberal economies we must hope that the COVID-19 reset indeed prevails.