Business in times of crisis

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Abstract: Government bailouts of corporate sectors in the COVID-19 crisis are part of a tripartite arrangement between government, business and institutional investors. Business should respond to the changing preferences of customers, employees and societies by identifying value propositions that justify the provision of risk capital by institutional investors. Critical to this is the determination and implementation of corporate purposes by owners and board directors that focus on inter-generational horizons. Family owners are particularly well placed to do this, but institutional investors need to make it part of their stewardship function as well. Measurement is key and significant reforms are required in the areas of accounting, valuation and reporting. Consistent with these observations, companies that had strong environmental, social and governance records performed better during the initial stages of the crisis, as did family owned firms and those that avoided high levels of leverage prior to the crisis.

Keywords: COVID-19, crisis, purpose, ownership, governance, boards, family business, institutional investors, measurement

JEL classification: E32, G32, L21, M4

I. Introduction

Prior to COVID-19 there was mounting concern about the extent to which business was contributing to increasing environmental degradation, inequality and social exclusion. Surveys suggested that trust in business and business leaders was low, and only somewhat ahead of that in governments and politicians in the last years (Edelman, 2019). There are two contrasting views of how COVID-19 will affect this.

The first is that it will exacerbate the problem. Faced with serious challenges resulting from the implosion of its markets that call into question its survival, business will have to take ruthless decisions. What can an airline without passengers, a theatre or cinema...
without audiences, a bar or restaurant without customers possibly do? How can orchestras and football teams that cannot meet, let alone play or perform in front of others, function? What can they do other than close their premises, lay people off, cut costs and shut down their supply chains?

Until COVID-19 struck, business was in some cases seen to be more powerful than nation states. It was increasingly being called on by governments to undertake the services that the public sector was previously expected to provide. With COVID-19, the tables have been turned and business is turning to governments for bailouts in many countries. The expectation is now one of growth of government relative to the private sector.

The second view is that this is business’s opportunity to redress the low esteem in which it is currently held and demonstrate how it has a vital role to play in addressing the problems that confront nation states. What should we expect of business?

II. The role of business

The PR firm Edelman has undertaken a survey of how people around the world believe that business should respond to the crisis wrought by COVID-19 (Edelman, 2020). The survey reports that the most important perceived responses are to protect employees and provide products that help address the pandemic. Two-thirds of respondents globally said that companies’ responses would determine their decisions to purchase their brands in the future. Less than a third of respondents felt CEOs in particular had performed well during the pandemic. In the same survey, in a telling reversal, government replaced business as the most trusted institution.

The significance of the actions of companies towards their stakeholders—employees and societies—is reflected in the share price response around the time that stock markets reacted to the crisis. We examined the share price performance of 1,827 companies listed on the New York Stock Exchange and Nasdaq on which we had environmental, social and governance (ESG) data by Thomson Reuters Eikon over two periods—first from 21 February to 23 March 2020 when the stock market indices dropped from peak to trough, and then from 24 March to 17 April when they started their recovery. We regressed the buy-and-hold abnormal returns (the difference between the buy-and-hold returns on a stock and its benchmark index) of companies’ shares over the two periods on their ESG scores (and the environmental, social and governance scores separately), various measures of ownership (shareholding types, to which we refer later in the article), profitability (measured by gross profit margins), leverage (debt as a percentage of total assets), liquidity (measured by current ratios calculated as current assets to current liabilities), firm size (measured by the natural logarithm of net sales), stock price volatility (measured by beta estimated over the previous 180 trading days based on dividend-adjusted daily stock returns), and valuation (measured by Tobin’s Q); all measured before the start of the estimation period. Country and industry controls were also included in the regressions.

As Table 1 records, the variables explain nearly 60 per cent of the cross-section variation in the downturn but only 15 per cent in the upturn. The ESG scores are positively and significantly associated with both downturn and upturn returns. Figure 1 reports the cumulative returns of top and bottom decile ESG companies and shows that, in
both periods, top decile ESG companies outperformed bottom decile firms. The regression implies that, holding other factors constant, buy-and-hold returns for a firm at the median of the 10th ESG decile exceeded those of a firm at the median of the 1st ESG decile by 5.9 per cent in the upturn.

These results are consistent with what others have reported in this and the previous crises. Ding et al. (2020) record that the fall in share prices in the COVID-19 crisis was smaller in companies with more corporate social responsibility (CSR) activities. Lins et al. (2017) report that firms with high social capital as measured by CSR had higher share price returns during the financial crisis of 2008–9 than firms with low social capital. They suggest that the reason for this is that trust built by investing in social capital pays off when trust in corporations and markets is subject to negative shocks.¹

¹ Unreported regressions also suggest that corporate performance in eco-efficient solutions, public health protection, business ethics enforcement, and product and service quality monitoring have a significantly positive impact on upturn returns.

### Table 1: Regression of buy-and-hold abnormal returns on ESG and ownership (from 21 February to 23 March 2020, and from 24 March to 17 April 2020)

|                        | Between 21 February and 23 March | Between 24 March and 17 April |
|------------------------|----------------------------------|-------------------------------|
| ESGa                   | 0.0003***                       | 0.0009***                    |
|                        | (2.7887)                        | (6.8103)                     |
| Family firm dummy      | 0.0256***                      | –0.0721***                   |
|                        | (3.7690)                        | (–13.6226)                   |
| Hedge fund shareholding| –0.0003***                     | –0.006*                      |
|                        | (–2.7132)                      | (–1.9176)                    |
| Pension shareholding   | –0.0001                        | –0.0011***                   |
|                        | (–0.2987)                      | (–6.8975)                    |
| Mutual fund shareholding| 0.0005                        | –0.0016**                    |
|                        | (0.6566)                       | (–2.4688)                    |
| Government shareholding| –0.0007***                     | –0.0018**                    |
|                        | (–3.0189)                      | (–2.0262)                    |
| Gross profit margin    | 0.0001**                       | 0.0004***                    |
|                        | (2.1140)                       | (4.4875)                     |
| Debt to assets         | –0.0005***                     | 0.0002*                      |
|                        | (–4.1055)                      | (1.6931)                     |
| Current ratio          | 0.0052***                      | –0.0002                      |
|                        | (11.3149)                      | (–0.3342)                    |
| Revenueb               | 0.0071***                      | –0.0001                      |
|                        | (4.9615)                       | (–0.0477)                    |
| 90-day beta            | –0.2939***                     | 0.1390***                    |
|                        | (–22.6685)                     | (16.4775)                    |
| Tobin's Q              | 0.0069***                      | 0.0077***                    |
|                        | (17.0429)                      | (19.6365)                    |
| Constant               | –0.1610***                     | –0.1525*                     |
|                        | (–3.5221)                      | (–1.7548)                    |
| Country                | Yes                             | Yes                           |
| Industry               | Yes                             | Yes                           |
| R-squared              | 0.585                           | 0.153                         |
| Observations           | 1,827                           | 1,827                         |

Notes: a The coefficients on environment, social, and governance variables when separately included were 0.0002*** (4.1881), 0.0001*** (2.6391), and 0.0002 (1.3342) respectively in column 1 and 0.0004* (3.2323), 0.0005*** (4.3233), and 0.0007*** (6.9071) respectively in column 2, b independent variable is natural-log transformed. * p < .1, ** p <.05, *** p < .01.
Investing in social capital may therefore be a form of insurance that creates resilience to negative shocks to trust. However, the COVID-19 crisis has revealed another way social capital can act as a form of insurance, which is related to the role of government. Many governments around the world have injected vast amounts of finance into their corporate sectors, in the form of loans, grants and tax breaks. That funding is being provided on the presumption that companies will respond by addressing the immediate crisis and helping to rebuild economies post-crisis. In particular, funding is in general...
designed not just to support companies and bail them out, but also to sustain employment and the most exposed parts of society. In other words, there is a belief that companies should be supporting their stakeholders as well as their shareholders.

The ability of governments to do this derives from public support for these programmes. There is a general recognition of the need to avoid catastrophic business failures through monetary and fiscal policies. However, that public support is conditional on companies responding by supporting their stakeholders. It will quickly evaporate if that fails to happen. That is precisely what occurred in the financial crisis. Initially, there was broad public support for the bail-out programmes adopted by several governments as a way of avoiding collapse of financial systems. However, that support disappeared and turned to anger and derision when the banks failed to respond sufficiently rapidly by recognizing their part of the social bargain in reforming their activities.

The current public funding programmes should therefore be viewed as part of a mutual relationship between business and government in which the latter supports the former in anticipation of the former supporting their communities and societies. Companies’ response in this crisis will determine future levels of trust in business and how their relationship with society is viewed in the long term. It is vitally important that companies do not make the same mistake in this crisis as banks did in the financial crisis and squander public goodwill, because the consequences of so doing will be even more serious than after the financial crisis.

So how can companies emerge from this crisis with a trust surplus not deficit? Business is often rightly or wrongly perceived to be self-interested in the sole purpose of making money. Indeed, now more than ever, when business faces existential threats, it might be thought justified in focusing on its financial viability. Other purposes are nice to have but need to be jettisoned or at least side-lined in the fight for survival.

To embrace this perspective would be a mistake. The purpose of a business refers to the reason for its being. It is neither just a description of what it does—a mission statement—nor what it aspires to become—a vision statement. It is about solving problems that individuals, societies and the natural world face (and which it would find difficult or impossible to solve individually) and doing so in a form that is commercially viable and profitable. Never has the notion of the purpose of business being ‘to produce profitable solutions to the problems of people and planet, and not to profit from producing problems for people or planet’ (Mayer, 2018) been more relevant.

To be able to do this, business needs to be clear about what purpose it can serve—what problems it can solve, whose problems, how it can solve them, when, and why it is well suited to solving them. It needs to mobilize its stakeholders—its customers, employees, suppliers, and communities and investors—to support it and support them in delivering this purpose. It should demonstrate how these are financially viable objectives that warrant the support of its investors.

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2 Financial Times, Kaye Wiggins, 12 May 2020, ‘Now is the time to emerge as a corporate “saint” not “sinner”’, online via https://www.ft.com/content/e85eb8f8-5d77-11ea-ac5e-df00963c20e6
Part of this response will require cooperation. In some cases, business will need to pool information and understanding to create a ‘knowledge commons’ that spans borders and is open and freely available. This particularly applies to efforts in medical development and testing, meeting the need for rapid production of necessary goods, and avoiding waste and loss as buying patterns shift. The swift ramping up of production of penicillin during the Second World War is an illustration of what can be achieved with cooperation.

For corporations, the absence of restrictive patents eliminated traditional barriers to sharing resources. As early as 1942, industrial groups entered into agreements to exchange information and specimens with one another. The first to do so were Merck and Squibb, joined a year later by Pfizer. (Quinn, 2013)

Corporate purpose is at the centre of such cooperation. As George Merck, President and Chairman of Merck between 1925 and 1957, said:

We try to remember that medicine is for the patient. We try never to forget that medicine is for the people. It is not for the profits. The profits follow, and if we have remembered that, they have never failed to appear. The better we have remembered it, the larger they have been.3

Merck’s words were true then and they are now.

More recently, several of the world’s leading plasma biopharma companies have formed an alliance to develop a COVID-19 immunoglobulin product from convalescent (COVID-19 survivors) plasma, which could lead to a plasma-derived therapy for treating the virus. This highlights how purposeful behaviour can foster collaborations even between fierce competitors. The alliance facilitates interactions with stakeholders such as universities and governments that can communicate research to the collective body of the alliance not just individual companies. In times of crisis, a collective endeavour, where business, government, investors and stakeholders around the world recognize their mutual dependence, is particularly critical.

Corporate purpose determines not only how business should be responding to the crisis but also how it should make the difficult trade-offs associated with those responses, for example between retaining employees or cutting costs and prices charged to vulnerable customers, between providing the equipment that societies require or sustaining dividends paid to pensioners. Associated with the purposes of businesses should be values that define precisely how companies should be prioritizing the needs of different parties impacted by their decisions in a transparent manner.

There are three components to the required business response—short, medium, and long term. In the short term, companies face difficult trade-offs between protecting their stakeholders and preserving their solvency. Companies are expected to support the production of protective, testing and tracing equipment, ventilators, treatments, and vaccines. What business is well placed to do, better than government, is the decentralized experimentation required to provide ongoing novel, innovative solutions, and the flexibility to provide such support rapidly where needed.

3 George W. Merck, 1 December 1950, Commemoration of Founders Speech at Medical College at Richmond.
In the medium term, preferences and values of individuals and societies will change. There will be substantial implications for ways of working, travelling, and communicating. Changing commercial and social expectations of business will require companies to reassess their priorities to maintain the trust of their stakeholders. A clearly articulated corporate purpose can and should guide the strategies that they adopt in response.

In the long term, businesses will have to demonstrate that their chosen strategies are commercially viable. Much of the funding available to companies from governments comes in the form of loans and debt. However, companies will require risk-bearing equity sources. As discussed below, financial institutions will have to respond by making this equity funding available. But business in turn will have to demonstrate that the injection of the equity capital is justified by both the returns that it yields for investors and the goods and services it creates for people and planet. Those long-run viable business opportunities will need to be determined by companies’ purposes and linked to strategic and operational priorities. Purposeful leadership, ownership, stewardship, and measurement will be key to putting purpose into practice.

III. The role of corporate governance

The COVID-19 pandemic arrived on the back of significant corporate attention to concepts of purpose and sustainability, such as the 2019 Business Roundtable declaration in the United States and the World Economic Forum’s 2020 ‘Manifesto’ on stakeholder capitalism. It also highlights tensions within business, including both corporate dependence on global supply chains and exposure to shocks on the part of countries reliant on exports to specific sectors for their survival.

What happens to corporate purpose in times of crisis? Who owns it, and who is able to make the long-term commitments that are required to respond to crises? In many cases, these questions become clearer when thinking of ‘long term’ as ‘inter-generational’. First, current crisis aside, the key agendas on which coordinated corporate action is required (e.g. achievement of the United Nations’ (UN) Sustainable Development Goals, advances in gender equality through the UN Global Compact’s Women’s Empowerment Principles, and progress in the face of climate change) all require commitments on a far longer term than the tenure of the average CEO (PricewaterhouseCoopers, 2018). Advancement on these issues demands commitments across generations. Second, many of firms’ key stakeholder commitments are similarly inter-generational in nature, as is the case, for example, with employment via investments in training, reskilling, and commitments to employee pensions.

In short, the time horizon for firms’ potential impact on stakeholders is frequently not matched by mechanisms to enable commitments or accountability on the part of a firm over corresponding timescales. Our second observation is that ownership and governance are therefore crucial aspects of the need for corporate action on sustainable development and net zero goals, and even more so in the face of COVID-19. Progress on such issues requires sustained commitment, over many years, by organizations. Corporate governance means that directors, along with a subset of active owners with
long-term perspectives, are uniquely placed to make commitments on behalf of the firm and be held to account to them through governance mechanisms.

In 2014, McKinsey and the Canada Pension Plan Investment Board (CPPIB) asked 604 executives and directors around the world what was the main cause of their organizations’ overemphasis on short-term financial results. The most frequent response, cited by 47 per cent of those surveyed, was the company’s board (Bailey et al., 2014). Additional recent research (INSEAD Corporate Governance Centre, 2018) on directors and sustainability confirms that many board members are not equipped to deliver on long-term purpose commitments (Smith and Soonieus, 2019).

This stands in contrast to the commonly held view that board members claim unique legitimacy in their mandate to set and uphold a corporation’s purpose. Owners arguably represent the only other viable contenders for this role, and this is only plausible when ownership is not highly dispersed, and shareholdings are suitably long term. In such cases, the ability of firms to target resources in a given direction in a sustained manner can be a function of their ownership, and the role of owners, as against short-term investors, is to steward wellbeing of the firm and its stakeholders over an inter-generational time horizon. Few among the most substantial corporate shareholders today fit this bill. As we discuss later in this paper, such owners are often in fact managers—intermediaries, agents—acting on behalf of others, the investors whose investments they manage.

Third and finally, as many of the world’s largest companies wrestle with uncertainty and face difficult trade-offs in the wake of the current pandemic, the question of how companies translate their purpose into decision-making is highly salient. When effective, corporate purpose will drive strategy decisions during crisis. As noted above, the effects of COVID-19 will be felt across the short, medium and long term, and the duty of directors is to steward firms’ response in these three phases, in line with their corporate purpose.

If corporate purpose is not contributing to strategy and decision making in this way at this time, firms should ask whether this is for one of two reasons. Is the corporate purpose serving as window dressing? In this case, it may be a distraction or, in some cases, something more nefarious. Second, do directors understand their role as stewarding the purpose of the corporation, particularly with an inter-generational view of shareholders and stakeholders in mind? This is the question the public is likely to ask when assessing corporate responses to the COVID-19 crisis.

In the current context of COVID-19, as we describe below, even long-standing owners currently face concerns regarding business continuity and, in some cases, survival. This brings attention back to our core contention that corporate purpose, now as ever, is the remit of corporate governance. Owners and directors have unique responsibilities for the long-term and inter-generational commitments of a firm and have particular legitimacy in setting the purpose of a corporation. This should be reflected in board mandates which strengthen business’s ability to respond to crises, and to deliver on commitments to stakeholder capitalism.

To bring governance centre stage in the delivery of corporate purpose, not just in these times of urgency, but at all times, company boards should undertake annual, externally audited appraisals of the enactment of their company purposes and report the results at their Annual General Meetings for shareholder endorsement. These reports should include assessments of how the board has formulated and embedded purpose in
its business, the relation of purpose to corporate strategy, values and the culture of the firm, the allocation of resources in relation to the business’s purpose and the measures against which purposes are evaluated. As described later, such measures would allow purpose to be appropriately reflected in governance and enable directors to take up their role as stewards of the firm’s purpose in crisis and beyond.

IV. The role of shareholders and investors

Table 1 records that companies with high levels of leverage and low liquidity ratios performed significantly worse during the stock market collapse in February and March 2020. High levels of leverage might have resulted from previous dividend pay outs and share repurchases, and at this point many companies need to rebuild their balance sheets by issuing new equity and cutting dividends as well as raising debt.

In April 2020, the UK’s asset management trade body, the Investment Association, wrote a letter4 to the Chairs of FTSE 350 companies stating how its members would like to see companies responding to the COVID-19 crisis. It stated that investment institutions would support companies in temporarily cutting their dividends, reducing executive pay, issuing new equity (possibly without existing shareholder rights), holding shareholder meetings in unconventional forms, and delaying publishing their financial results.

By normal standards these were radical suggestions. The reason given for them was the wish of asset managers as stewards of British companies to support UK Plc and the wellbeing of citizens and societies facing unprecedented challenges. It sought to do this through promoting well-run companies that ‘take a long-term view of how they treat their employees, communities, suppliers, pension savers and customers’.

This response of UK institutional investors is comparable with another group that is thinking carefully about their role as stewards of corporate equity—family owners of large companies. They are a particularly interesting comparison if only because family ownership is the most significant form of share block holding around the world (Franks and Mayer, 2017). Even in the largest listed companies, families are the dominant holders of significant blocks of shares in nearly all countries, with the UK being one of the few exceptions.

Table 1 shows that family firms outperformed other companies during the stock market collapse from late February to early March while underperforming others during the early recovery stage from late March to early April.5 These seemingly contradictory results add to early findings by Villalonga and Amit (2010), who showed that the presence of founding family mitigates a firm’s sensitivity to both negative and positive earning shocks. The positive effect of family owners on stock returns can be explained by a competitive advantage or ‘propping up’ by founding families sharing their

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4 The Investment Association’s letter to the chairs of FTSE 350, 7 April 2020. Online available under https://www.theia.org/sites/default/files/2020-04/Letter%20to%20FTSE%20Chairs%20-%20April%202020.pdf

5 Following Villalonga and Amit (2010), we define a family firm as one that has an equity stake of the founding family or a member of the founding family serving on its board.
private resources and provide temporary support to financially distressed firms, thereby putting them in a stronger competitive position to weather economic adversity than non-family firms (Friedman et al., 2003). Conversely, under a ‘tunnelling’ argument (Bertrand et al., 2002) founding families also seek to appropriate private benefits at the expense of nonfamily shareholders. As a result, non-family investors are protected from downside risk by virtue of the founding families’ competitive advantage but limited in their potential upside gains.6

A separate analysis of the response of a subset of the largest family businesses with revenues in excess of $1 billion around the world, many in their fourth generation over more than 100 years, reveals three issues as being of primary interest to families in the COVID-19 crisis.7 The first is their employees—their security, and health and wellbeing, including the preservation of their employment and income. Some families have stated that they are willing to forgo dividend payments if that is what it takes to support their employees. The second is business continuity. Strikingly for some of the largest, most prominent, and oldest businesses in the world, they are concerned about the survival of their organizations. In many cases they, like so much of business, face existential threats in current circumstances. If these businesses are concerned about their survival, it is not difficult to imagine the degree of threat confronting the vast majority of family businesses, which for the most part are the smallest not the largest companies in the world.

The reason continuity is so important is that enduring families generally tend to regard their businesses as being here for the long term. It is not unusual for family owners to articulate a strong sense of responsibility to their forebearers who strove to create their businesses and to their descendants to whom they wish to bequeath them. The commitments they offer their employees and other stakeholders are often given—tacitly or explicitly—on the understanding that business-owning families are invested for the duration of those commitments. At its best, this perspective is therefore truly long term in the sense of inter-generational, as described above.

The third focus of large family owners is on their communities and societies. What typically distinguishes family owners from their institutional investor equivalents is that their name is on the tin, and if not explicitly then certainly inside it. In many cases, families cannot hide behind the anonymity of dispersed shareholders and a long chain of investment owners, managers and advisors. They are prominent not just within their firms but outside them in their communities and societies. In the best-case scenario, this instils a strong sense of responsibility of family owners to their communities as well as their employees.

In essence, family owners often regard their employees and local communities as part of their extended families. But even in the best of times, not all family owners are by any means paragons of virtue. On the contrary, some illustrate the worst abuses of business practice observed anywhere in the world. That reflects the power that holders of large blocks of shares can exert for good or ill and the particular responsibility that rests on them to demonstrate the former.

6 As far as other types of investors are concerned, although mutual funds and asset management companies may strive to maintain long-term investment perspectives, they are subject to liquidity shocks and withdrawals. Our results suggest that firms with greater shareholding of hedge funds and mutual funds experienced more severe declines of share prices, consistent with the findings of Ding et al. (2020).

7 The Ownership Project (2020), Said Business School, University of Oxford
In contrast, companies with dispersed shareholders do not have owners who take responsibility for their companies in the same way that families can. The initiative that the Investment Association has taken in writing to UK company chairs places its members on a par with the most enlightened family owners. The advantage that institutional investment in public equity markets has over family ownership and private equity more generally is its transparency. There is a greater accountability of institutions in public markets to their investors, regulators and society at large than in private markets. That is a significant factor behind the initiative of the Investment Association in writing to company chairs, not as families, but as stewards of capital that are also concerned about the reputation and standing of their companies in society.

But asset managers are not owners. Even those referred to as ‘asset owners’, such as pension funds, are not technically owners because they are acting on behalf of their ultimate beneficiaries—their savers and pensioners. What the Investment Association letter recognizes is that institutional investors are de facto owners and stewards of capital who must take responsibility for the actions their companies take.

Exceptional circumstances wrought by COVID-19 are hastening pre-existing efforts to redraw the relationships of responsibility between corporations, stakeholders, and investors. The 2020 UK Stewardship Code is one such example of an effort to define a new balance to address pre-COVID-19 crises: climate change, the future of work, inequality, and social exclusion. The pandemic has reinforced the importance of the Stewardship Code in ensuring an alignment between purposeful companies and their investors.

V. The role of measurement and reporting

A key problem that the implementation of purpose beyond profit faces at all companies—small, large, public, or private—is measurement. Existing financial performance measurement and reporting systems are not fit for purpose and can create perverse incentives.

Focused on financial profit, companies in crisis are incentivized to cut wasteful costs associated with their employees rather than to recognize and protect them as an important asset needed to build resilience and recovery. Equally, companies might be hesitant to cut dividends even if they need liquidity, knowing that the market will likely respond by slashing their share price, which might encourage interventions by short-term profit-oriented activist investors or hostile acquirors seeking bargain purchases. Challenges regarding performance measurement also confront investors who are expected to evaluate and steward corporate performance in unprecedented circumstances. ESG performance measures, based on static, backward-looking annual scores, might not be reliable when dynamic, forward-looking data are required.

Three performance measurement systems are key for a more holistic measurement of performance and purpose: accounting, valuation, and reporting. All three systems rely on consistent non-financial measures which are then converted into either objective costs, subjective valuations, or direct reporting. Done right, they can help companies and investors to navigate and communicate through the crisis and maintain a long-term perspective and a high level of trust among their stakeholders.
Accounting is the foundation of a company’s bookkeeping and tracks its income, expenditure, assets, and liabilities—in short, it counts what the company has, owes, and spends. The bottom line of accounting is financial profit. This figure determines the retained earnings of an organization and consequently its ability to pay higher or lower dividends. But financial profit in its current form is incomplete. While taking into account physical and a limited amount of intangible assets (such as brands), it does not consider non-financial dependencies. A more meaningful form of bookkeeping would extend financial accounting to allow for the capitalization of key environmental, human, and social assets, which are currently recognized as operating expenditure. In conditions where cost cutting is required, they are therefore the most exposed expenditures. In contrast, recognizing expenditures on training of employees as investment in companies’ human assets creates different incentives.

Adjustments like this allow for the determination of profits net of harm—a particularly important concept in times of crises such as COVID-19. In the short term, companies and investors can therefore use this type of information as a powerful form of communication about where and how companies are allocating their capital. In the long run, this particular form of accounting will require global standard setting and legal mandates.

But accounting cannot determine the positive and negative impacts of companies on their ecosystems and stakeholders. This is where valuation and reporting are relevant. Valuation can establish the financial value of a company’s impacts beyond its legal boundaries by identifying monetary multipliers that convert absolute values of non-financial measurement into monetary terms. This allows the company to estimate the full financial effect of its externalities on other parties as well as its contractual earnings and expenditures. Valuations are then a reflection of what companies create and destroy for society as a whole, as well as for their shareholders.

Valuation can be used for investment appraisals at functional levels within companies, in strategic decisions by boards, and by investors in portfolio allocations. This is why it is a potentially powerful tool in times of crises, such as COVID-19. For example, a board can model the societal impact of not providing paid sick leave to its employees and use it as communication tool to support decisions to provide employee protection. Investors can do the same and contextualize the harm and benefits of investment decisions in supporting dividend cuts or new equity issues during the crisis.

Finally, corporate reporting takes the numbers created by accounts and valuations and explains and contextualizes them. Reporting is often qualitative and non-monetary, giving companies the opportunity to share their purpose, explain scenario analyses, and clarify data. Disclosure is therefore fundamental to enlightened stewardship and investment analysis both in the short and long term. To create a level playing field for companies, a small set of standardized and legally required non-financial measures are desirable for both public and private companies. A variety of initiatives are actively working towards this goal.8

8 See for example the work done by the non-profit Impact Management Project (convening organizations such as the Global Reporting Initiative GRI and the Sustainability Accounting Standards Board SASB), the EU Non-Financial Reporting Directive (2014/95/EU), the World Economic Forum’s 2019 report in collaboration with the International Business Council, and the recent working paper of Accountancy Europe on ‘Interconnected Standard-Setting for Corporate Reporting’.
During COVID-19, companies can and should use their reporting capacity to communicate to their investors how they assess and estimate the risks of the crisis for their business. On 8 April 2020, the US Security and Exchange Commission (SEC) issued a letter to all US listed companies in which it urged them to disclose:

(1) where the company stands today, operationally and financially, (2) how the company’s COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and financial condition may change as all our efforts to fight COVID-19 progress.

The forward-looking nature of this required disclosure was emphasized by the addition that ‘historical information may be relatively less significant’ for this exercise.

VI. Conclusion

COVID-19 has highlighted two possible stylized business responses—profit before purpose or purpose before profit. This article suggests that purpose should come before profit despite apparent pressures, and that the dichotomy between them is a false one. Evidence from share price responses of companies to the crisis supports that conclusion.

The significance of corporate purpose is relevant to all three stages of the crisis—short, medium, and long term—and the determination of the difficult trade-offs that need to be made. In formulating and enacting its purpose, boards and owners have particularly important roles to play. They should recognize not just the long-term but the inter-generational nature of the horizons that are required to identify how their purposes should be implemented during all three stages of the crisis.

That is of particular relevance in identifying the value propositions which justify support from investors in providing necessary risk capital. Family ownership is an example of an ownership structure that can take inter-generational perspectives, but it is as important in the context of the stewardship function that institutional investors need to perform in widely held companies.

Critical to the ability of boards, owners, and investors to perform this function are the measurement systems available to them. Significant advances are needed in three areas, in relation to accounting, valuation, and reporting. These should recognize the impacts that companies have outside as well as within their legal boundaries, the investment expenditures that are required in delivering their corporate purposes, and the value that is created by doing this.

The bailouts that companies are currently receiving from governments around the world are part of a tri-partite arrangement between government, business, and investors. The funding is being provided on the presumption that the corporate sector will recognize its responsibilities to its societies as well as its shareholders, and that shareholders appreciate their responsibilities to support and encourage the corporate sector to do this. Governments should understand the nature of this arrangement and not presume its success. If businesses fail to rise to the challenge, then the consequences for the ownership, regulation, and taxation of our capitalist system, let alone our societies and environment, will be devastating for years to come.
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