Governments have taken unprecedented measures to safeguard people’s lives from the Coronavirus Disease 2019 (COVID-19). These have had a massive impact on the global economy and laid bare the complex relationships between governments, companies, and society as a whole. Government and central bank initiatives are significantly helping many listed companies, throwing them a lifeline at a time of crisis. However, these extraordinary interventions appear to have come with conditions. Many governments are encouraging listed corporates to show restraint on shareholder distributions, urging them instead to use their capital to reinforce their balance sheets and support their employees. Government initiatives are likely to have lasting consequences for equity investors.
Just as bankers’ pay drew public and political ire during the Global Financial Crisis when banks were bailed out, company dividends are in the crosshairs as a result of this pandemic given many companies are now direct beneficiaries of government support in terms of access to borrowing or subsidies for employees’ wages. Government intervention in free market economies has never been more pervasive except during wartime, exceeding responses to natural disasters and previous economic crises. Government expectations about corporate behaviour have suddenly become more central to corporate decision making and, as a result, managements’ attitude to shareholder returns, financial leverage, and economic burden sharing will likely be reassessed and adjusted.

In the same way government largesse in rescuing financial institutions during the Global Financial Crisis reshaped the behaviour expected of banks, we believe that companies will have to respond to this public health crisis by enhancing their societal license to operate—i.e., strengthening their relationships with both direct and indirect stakeholders. The strength of these relationships is determined by company behaviour and we are already seeing a marked shift since the start of the COVID-19 pandemic. The ideology of shareholder primacy was already under pressure as some asset owners have focused more on sustainability and an approach to business that acknowledges society and the environment. The current pandemic may accelerate that trend.

As posited by Lazard’s Global Thematic Equities team, every company effectively relies on a societal license to operate, something investors tend to overlook. As the team sets out in their paper, A Sustainability Framework: Societal Shifts as Investment Risks, companies with deteriorating societal licenses are particularly vulnerable as they are likely to draw public condemnation and more stringent government regulation. Consequently, a societal license to operate is key to generating profits sustainably over time, and especially during periods of intense economic stress. We believe the COVID-19 pandemic is highlighting the usefulness of this concept.

How Did We Get Here?

By definition, companies are legal entities, incorporated to limit the liability of shareholders to their capital invested, and no more. By limiting liability, shareholders can invest knowing that their losses are limited to the value of their investment. In return for that investment, an investor can expect to accrue the benefits of ownership, in the form of dividends—i.e., income—as well as capital growth, as a company profitably reinvests in the business rather than returning all profits to shareholders.

However, no economic agent operates without constraints. Companies’ very existence is predicated on the legal concept of incorporation. Companies are subject to taxation, they are often directly regulated by various government bodies, and are required to comply with the laws of the jurisdictions in which they operate. These specific obligations are supplemented with broader responsibilities to the rest of society, including customers (which may include individuals, other companies, and governments), and employees, as well as shareholders.

Customer preferences directly and indirectly influence what companies produce and even how they produce it. Talented workers may demand changes in business operations or shun a specific employer if they believe the company’s behaviour conflicts with their personal values. Corporate activity can easily become an issue worth campaigning against, fuelling calls for reform from voters and the governments they elect. Governments have a mandate to regulate industries and companies, but the values and principles they use to do this can change over time.

Corporate behaviour that might have been acceptable for years, or even decades, can suddenly be viewed negatively. Companies need to manage multiple stakeholders on a day-to-day basis. For example, pharmaceutical executives may receive praise for leading the development of lifesaving treatments, but will be pilloried for raising drug prices. Manufacturers may be lauded for lowering the price of goods and in doing so improve accessibility to a broader consumer base, but will be lambasted for outsourcing manufacturing jobs to other countries. Other practices can prove not to be socially acceptable and attract regulation, such as the price gouging of vulnerable people through predatory lending.

Further reading:

A Sustainability Framework: Societal Shifts as Investment Risks

The Global Thematic Equities Team has developed a proprietary framework to evaluate sustainability risk.
How COVID-19 Could Accelerate Change

Some asset owners were already seeking an improvement in the trade-off between financial objectives, on the one hand, and societal and environmental outcomes on the other. This movement could develop more force in the wake of this pandemic. Management’s responses and actions in a time of crisis offer rare insight into their priorities as well as their abilities. For investors interested in sustainability, the COVID-19 pandemic is an opportunity to see how companies are reacting to a sudden and dramatic test of their business models and assess how they are weighing the interests of their different stakeholders, as we discuss in our paper: Perspectives on Protecting Human Capital.

What Corporate Actions Reveal So Far

In this section, we highlight some of the specific corporate behaviours we have seen in response to the COVID-19 pandemic, grouped into four broad categories (Exhibit 1). We believe the strength of a company’s societal license to operate could impact its operating trajectory once we emerge from this public health crisis.

Financial Support

In this category we include a number of measures which are financial in nature and benefit direct stakeholders such as customers, employees, and suppliers.

Measures for customers

Business to consumer: Many European banks and utilities have offered payment holidays and waived the consequences of late payment. For instance, the Royal Bank of Scotland in the United Kingdom announced a three-month mortgage payment holiday for affected customers a week before the UK government decided that such a rule should become standard. Similarly, most utility companies in southern Europe have agreed not to disconnect customers if they fail to pay their bills.

Business to business: Several classified businesses (e.g., Autotrader, Scout24, and Rightmove) that act as advertising platforms for the sale of cars and houses have temporarily, but significantly, reduced fees to support their customers. For instance, Rightmove cut its fees by 75% for four months. Whilst one could view such moves purely through the lens of the price elasticity of demand, it seems to us that the scale of these cuts reflects an effort to ensure the longer-term viability of their customers.

Measures for employees

Despite companies facing lengthy closure of their retail premises, numerous companies have sought to continue to employ staff and safeguard them financially, including Disney and Starbucks. Other companies, such as Unilever, have gone further by committing to cover the pay of not only their full-time employees, but also for contractors and other part-time workers.

Some of the companies not subjected to lockdowns, including grocery retailers, have put in place generous packages for their employees. In the United Kingdom, for instance, Tesco announced it would pay a 10% bonus to all shop staff for the period 9th March to 1st May. Furthermore, Tesco has elected to pay, in full, all of its vulnerable staff (groups considered to be at higher risk by official health bodies) and encouraged them to stay at home for 12 weeks. In the United States, Lowe’s, Dollar General, and Mondelez have elected to pay their staff bonuses, extend paid leave for their vulnerable staff members, and extend health care benefits to include those not enrolled in the company medical plan.

Exhibit 1
Corporate Responses Broadly Fall into Four Categories

Financial Support

Donations

Redirecting Resources

Social Measures

For illustrative purposes only.
Source: Lazard
A number of gig-economy businesses have elected to extend sick-leave benefits to their self-employed workers. Contractually, most gig-economy workers that fall ill will lose their income as, typically, they are not afforded the same protections as employees in more traditional employment models. As such, this is an unusually generous move and it remains to be seen whether this softens the differences between gig economy and full-time employment models longer term, as we discuss in our previously published paper: *Understanding the Investment Implications of the Gig Economy*.

Many CEOs and other executives across different industries are taking partial or full pay cuts, particularly those most affected by the economic fallout from the virus. Qantas made a particularly strong and early gesture in this regard. On 10th March, the company announced that the CEO and Chairman would not take a salary for the remainder of the current financial year. On 19th March, this was extended to include Senior Group Management Executives and the entire Board. Annual management bonuses have also been cancelled. This was positioned as being in solidarity with the airline’s other employees, many of whom have been asked to take unpaid leave.

**Measures for suppliers**

Companies, particularly in the food supply chain, have elected to improve the working capital cycle of their smaller suppliers by improving their payment terms. Most grocers have elected to do this for their smaller suppliers, as have some of the staples companies. This has also been seen in the telecommunications sector, with Vodafone improving its payment terms for small-to-medium enterprises from 60 days to 14 days, and Iliad from 45 days to immediate payment.

**Redirecting Resources**

A number of companies are redirecting their manufacturing or service capabilities to support the direct needs of health care systems and broader societies.

**Manufacturing**

Many companies have redirected their manufacturing capabilities to ramp up the production of:

- Hand sanitiser
- Personal protective equipment (PPE)
- Ventilators

Alcohol-based hand sanitiser has a high concentration (approximately 70%) of alcohol, such as ethanol or isopropanol. The increased production in response to the COVID-19 outbreak started with soju manufacturers in Korea donating their distilled alcohol, but has since grown to include companies such as Diageo and Anheuser-Busch, who have redirected their distilled alcohol away from beverages to produce hand sanitiser. LVMH, Beiersdorf, Unilever, and P&G (companies with manufacturing capabilities in compounding and bottling) are also manufacturing and donating vast quantities of the finished product.

Garment manufacturers ranging from Armani and Kering at the luxury end, through to Gap, UNIQLO, and Inditex—companies often criticised for promoting “fast fashion”—have re-purposed their factories to produce and donate PPE, including facemasks and scrubs, to medical workers around the world.

Similarly, Amazon has adopted an “essential items” policy, prioritising warehouse space for items that are deemed to be more important at this time and, as a result, only accepting certain products at its warehouses for sale through its marketplace. These goods are typically lower-margin items and could include toilet paper, nappies, and baby food, yet they are taking precedence over less essential items (despite worse economics) as Amazon flexes its last-mile logistic network to deliver necessary supplies on the basis of utility, not short-term profit maximisation.

Companies, including Medtronic, have also stepped up their response by manufacturing equipment around the clock, diverting people away from other production lines to ventilator manufacturing, and working with suppliers to secure needed raw materials. Through our engagement with the company, we have learned that Medtronic has doubled its production of its PB 980 critical care ventilator. Still, demand is certainly much higher than the industry’s ability to meet it, and so companies are teaming up with universities and companies in other industries, and even sharing designs and production equipment to increase production. Medtronic has decided to open source their lower-end ventilator designs and partner with other companies, including Tesla. Elsewhere, companies skilled at component assembly (such as Airbus, Ford, Fiat, BAE Systems, and Rolls-Royce) have committed to producing medical ventilators for patients displaying the most advanced symptoms of COVID-19, based on designs supplied by smaller (but highly technically proficient) medical device manufacturers.
Social Measures

Some companies have taken steps that do not have a direct impact on stakeholders, but which reinforce their role as positive actors during the pandemic by improving societal outcomes.

Preferential access

Actions in this category include offering special shopping times for vulnerable members of society, such as the elderly. This initiative started in Australia, pioneered by Woolworths and Coles who initially set aside one hour per week for vulnerable customers, just after the stores had been stocked, to enable them to access essentials. These measures have since been put in place by grocery retailers around the world and, in some places, have been extended to include online grocery shopping slots and other key workers, such as health care professionals.

Advertising

A number of companies have used their brand platform and presence to encourage good social practises. At the most intuitive end, Unilever, which owns several soap brands like Lifebuoy and Dove, is working closely with governments to educate consumers about handwashing and general hygiene. Unilever has invested heavily in new labels on packaging that explain how to wash hands most effectively, and in China the company has produced an 8-day “scientist online” series to distribute important health and hygiene knowledge to consumers. This has already reached approximately 50 million people.

Slightly more tangentially, Coca-Cola and Guinness (owned by Diageo) have been using their normal advertising spots in major thoroughfares to encourage social distancing. In London the BT Tower, owned by British Telecom, is using its digital billboard to display the message “Stay at home – Support the NHS – Save lives”. Finally, even oil and gas companies, such as GALP, are donating media space for public health messages.

Labour relations

Demand for labour has been significantly disrupted by the pandemic. Some companies that are experiencing high consumer demand—principally in the food supply chain—have been directly liaising with companies suffering from lower demand—such as in the hospitality sector—to create opportunities for people who no longer find themselves in work. Examples of businesses that are doing this include Kroger (which has agreed to a wholesale commitment to Sysco staff) and Morrison’s, the UK supermarket chain, which is liaising with a variety of challenged businesses. In some cases, staff have been redeployed to their new place of employment in as little as 24 hours.

Some companies are also showing unusually high sensitivity toward employees and their concerns about the risks of working in public. One example of this is Next, a UK-based fashion retailer, which, because its shops are non-essential, closed all of its physical stores on 23rd March. Although Next’s very profitable ecommerce operations were not prohibited from operating, Next nevertheless decided to shut its ecommerce operations on 26th March on a temporary basis, because staff in those facilities felt that working in the fulfilment centre posed an unnecessary risk.

Data sharing

Across Europe the incumbent telecommunications companies are sharing anonymised data with health authorities to help track the spread of Coronavirus. Similarly, Google is in discussions with governments in a number of geographies to share anonymised location data to see if messages about social distancing are working in practice.

In the same way, many health care companies and journals have agreed to freely share information about COVID-19, with the hope that working together will assist in accelerating the development of a vaccine or treatment protocol that works.

Donations

Some companies are helping in different ways, perhaps by simply donating cash, products, or services. In addition to these cash donations, some “in kind” donations have caught our attention owing to their sheer scale. These include Starbucks and Deliveroo providing free coffee and meals for thousands of health care staff, and Samsung providing travellers from Korea with “self-quarantine packs” (including noodles, medicines, and hand sanitiser) so they can more easily self-isolate upon reaching their destination.

COVID-19 and the Investment Landscape

COVID-19 has already had an enormous human cost in terms of loss of life and loss of income. Companies are responding, often very generously, but we suspect that their behaviour is not always altruistic. The depth and breadth of response suggests to us that companies are beginning to understand the importance of wider stakeholder sponsorship. The danger of attracting public opprobrium and a negative reaction from customers and employees has become very real, a risk amplified by
social media. No company can be seen to be ruthlessly maximising short-term profits and not expect there to be consequences.

There will also be consequences for investors. This is becoming increasingly tangible as governments, central banks, and local regulators in Europe, such as the Prudential Regulatory Authority in the United Kingdom, put pressure on banks and other companies to suspend dividend payments. Some might argue that this is unnecessary, not least because dividend distributions provide an important source of income some investors rely on, including pension funds, charities, and other savers such as retirees. However, in the face of such pressure, companies are likely to buckle. The dividend futures market is anticipating cuts across European-listed companies of 60%—almost double those that occurred during the financial crisis. In the United States, expectations for cuts have leapt by one-third in the past month.

Government support underpins banks’ business model: access to the central bank’s discount window (the lender of last resort function) allows them to turn loans into liquidity, and government deposit protection schemes that facilitate the collection of consumer savings. On 30th March, the European Central Bank said, “capital conserved by refraining from dividend distributions and share buybacks can also be used to support households, small businesses, and corporate borrowers, and/or to absorb losses on existing exposures to such borrowers.” It appears that the terms of the relationship between financial institutions and governments, a key stakeholder, have changed unilaterally.

While we have yet to see how banks redeploy the capital that was earmarked for dividend distributions, other companies have shown how they intend to put such capital to work, sometimes with clear advantages for the real economy. Accor, a global hotel company, cancelled its entire dividend, and committed to divert 25% of its value towards a hardship fund to pay for COVID-19 related hospital expenses for employees without social security or medical insurance, or for furloughed employees in financial distress. The hardship fund has been topped up by the board, which collectively took a 20% pay cut and redirected the savings into the hardship fund.

Some companies have been allowed to trade during government-mandated quarantines, in some cases even benefitting from a demand windfall as competitors’ routes to market have been closed. How much profit should companies that are allowed to continue to operate generate from this, and how much should they give back to suppliers, employees, and customers? In an environment where governments control the allocation of market share, price regulation or competition scrutiny often follows. This expectation of enhanced scrutiny likely contributed to the decision of grocery stores to pay their staff bonuses and introduce shopping hours for the vulnerable.

The concept of companies needing a societal license to operate has rarely been a more useful framework for thinking about the preconditions for companies’ long-term success. We believe that the decisions that management teams make now could have lasting consequences. We expect companies that successfully define their positive contribution to society as employers, providers of essential goods and services, and fiscal revenue will enhance their prospects at the expense of those that do not. Investors need to recognise that COVID-19 is challenging, at least temporarily, the notion of shareholder primacy and to focus on management attitudes towards shareholder returns, financial leverage, and economic burden sharing. Both investors and company executives need to recognise that these unprecedented times are prompting a reassessment of corporate responsibilities not just to suppliers, customers, and employees, but to society as a whole.
About the Authors

Nathan Cockrell
Managing Director, Co-Director of Global Research and Research Analyst
Lazard Asset Management Limited (London)

Nathan Cockrell is a Managing Director and Co-Director of Research. He also serves as a Research Analyst primarily covering the global consumer discretionary sectors. Prior to joining Lazard in 2007, Nathan worked for Credit Suisse, where he was a Director and Research Analyst covering the European retail sector. Earlier he worked as a retail analyst for Morgan Stanley and NatWest Securities in London. Nathan began working in the investment field in 1995. He has a BA in History from Cambridge University.

Contributors

Rhet E. Brown, CFA
Managing Director, Research Analyst
Lazard Asset Management LLC (New York)

Jennifer Anderson
Director, Co-Head of Sustainable Investment and ESG
Lazard Asset Management Limited (London)

Nikita Singhal
Director, Co-Head of Sustainable Investment and ESG
Lazard Asset Management LLC (New York)

Jonathan Morris
Managing Director, Research Analyst
Lazard Asset Management Limited (London)

Alistair Godrich, CFA
Director, Research Analyst
Lazard Asset Management Limited (London)

Natasha L.V. Cardale
Vice President, Research Analyst
Lazard Asset Management Limited (London)

Dennis Neveling, CFA
Managing Director, Research Analyst
Lazard Asset Management LLC (New York)

Jay Levy, CFA
Director, Research Analyst
Lazard Asset Management LLC (New York)

Edward Lund, CFA
Research Analyst
Lazard Asset Management Limited (London)

William Gore-Randall
Senior Vice President, Research Analyst
Lazard Asset Management Limited (London)

William Gore-Randall is a Research Analyst based in London. He began working in the financial services industry in 2007. Prior to joining Lazard in 2018, William was an Analyst with Albertron Capital. Prior to this, he held positions at Vitruvian Partners, Bain Capital, and The Boston Consulting Group. William holds a 1st Class M.A. (Hons) in Economics and Management from the University of Oxford.

This document represents the views of the author(s), and its conclusions may vary from those held elsewhere within Lazard Asset Management. Lazard is committed to giving our investment professionals the autonomy to develop their own investment views, which are informed by a robust exchange of ideas throughout the firm.

Notes

Important Information

Published on 16 April 2020.

The views and opinions expressed are as at the date of publication and are subject to change. Certain information contained herein constitutes “forward-looking statements” which can be identified by the use of forward-looking terminology such as “may,” “will,” “should,” “expect,” “anticipate,” “target,” “intend,” “continue,” or “believe,” or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events may differ materially from those reflected or contemplated in such forward-looking statements.

This document is provided by Lazard Asset Management LLC or its affiliates ("Lazard") for informational purposes only. Nothing herein constitutes investment advice or a recommendation relating to any security, commodity, derivative, investment management service, or investment product. Investments in securities, derivatives, and commodities involve risk, which may fluctuate in price, and may result in losses. Certain assets held in Lazard’s investment portfolios, in particular alternative investment portfolios, can involve high degrees of risk and volatility when compared to other assets. Similarly, certain assets held in Lazard’s investment portfolios may trade in less liquid or efficient markets, which can affect investment performance. Past performance does not guarantee future results. This document is intended only for persons residing in jurisdictions where its distribution or availability is consistent with local laws and Lazard’s local regulatory authorizations. The Lazard entities that have issued this document are listed below, along with important limitations on their authorized activities.

Australia: Issued by Lazard Asset Management Pacific Co., ABN 13 064 523 619, AFSL License 238432, Level 39 Gateway, 1 Macquarie Place, Sydney NSW 2000, which is licensed by the Australian Securities and Investments Commission to carry on a financial services business. This document is intended for wholesale investors only. Canada: Issued by Lazard Asset Management (Canada) Inc., 30 Rockefeller Plaza, New York, NY 10112 and 130 King Street West, Suite 1800, Toronto, Ontario MSX 1E3, a registered portfolio manager providing services to non-individual permitted clients. Dubai: Issued and approved by Lazard Gulf Limited, Gate Village 1, Level 2, Dubai International Financial Centre, PO Box 506644, Dubai, United Arab Emirates. Registered in Dubai. International Financial Centre 0467. Authorised and regulated by the Dubai Financial Services Authority to deal with Professional Clients only. EU Member States: Issued by Lazard Asset Management (Deutschland) GmbH, Neue Mainzer Strasse 75, D-60311 Frankfurt am Main. Hong Kong: Issued by Lazard Asset Management (Hong Kong) Limited (0472793). One Harbour View Street, Central, Hong Kong. Lazard Asset Management (Hong Kong) Limited is a corporation licensed by the Hong Kong Securities and Futures Commission to conduct Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities only on behalf of "professional investors" as defined under the Hong Kong Securities and Futures Ordinance (Cap. 571) of the Laws of Hong Kong and its subsidiary legislation. Korea: Issued by Lazard Korea Asset Management Co. Ltd., 10F Seoul Finance Center, 196 Seongdong-dao, Jung-gu, Seoul, 100-769. People's Republic of China: Issued by Lazard Asset Management. Lazard Asset Management does not carry out business in the P.R.C. and is not a licensed investment adviser with the China Securities Regulatory Commission or the China Banking Regulatory Commission. This document is for reference only and is not a substitute for advice from a registered investment advisor. No other advice or recommendation or, an offer to sell or an invitation to apply for any product or service of Lazard Asset Management.

This content, together with the data and other information in this document, should not be used as the sole basis for making investment decisions and should be considered in conjunction with other information. Any investment involves risk, and you may lose money. Past performance is not indicative of future results.