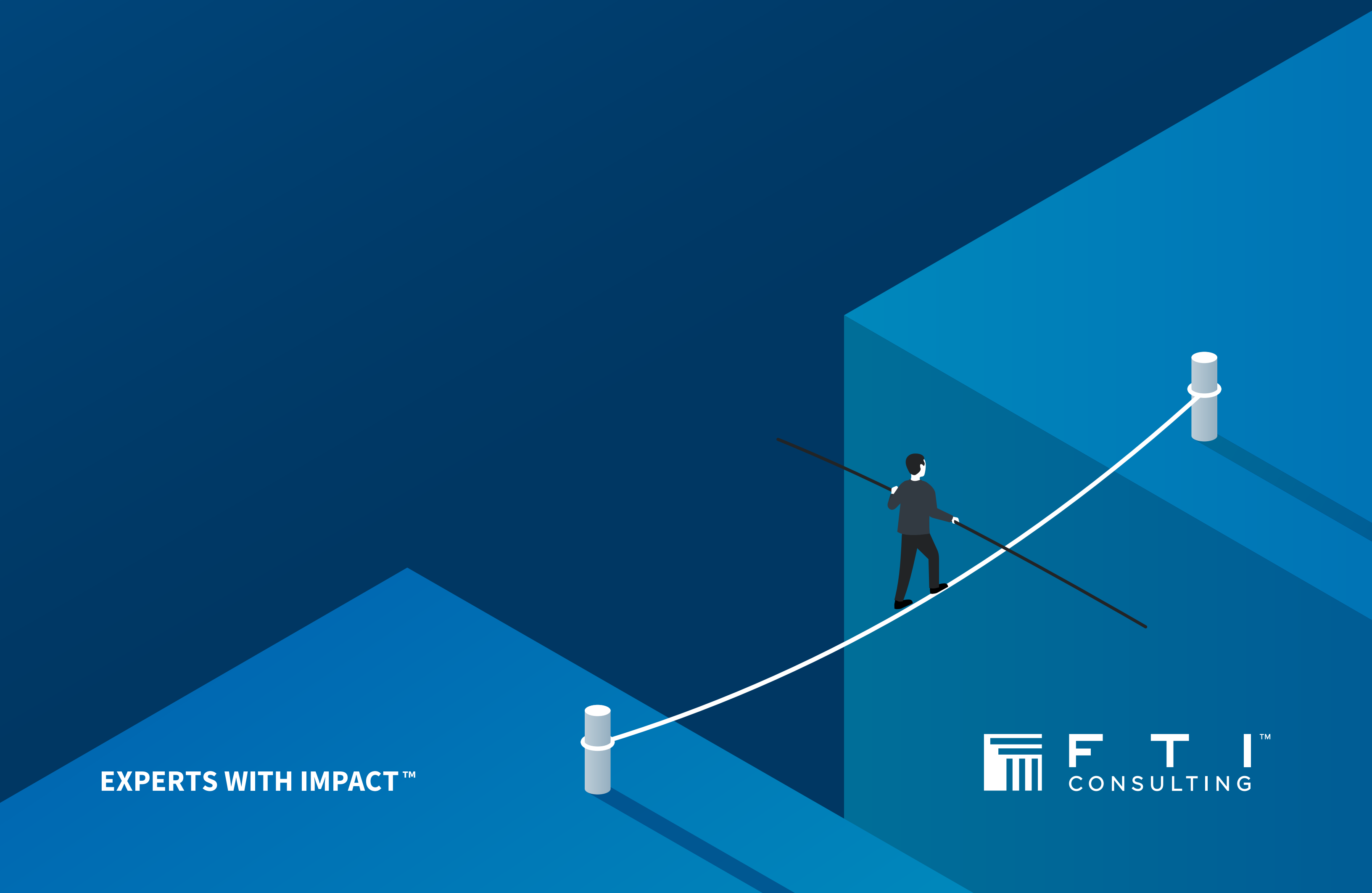
Walking a Tightrope Without a Safety Net

Latin American corporates trying to cross through the pandemic



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Businesses face a double burden amid the pandemic

With economic activity paused and revenues significantly down across most industries, many companies are fighting to survive. At the same time, they are facing unprecedented demands from increasingly vocal stakeholders: preserve jobs, prevent the spread of COVID-19, keep up fiscal commitments, support the communities where they operate and solve unprecedented challenges across the entire value chain. Getting through the next months and making it back to safe ground will require a remarkable balancing act.

This challenge is particularly daunting in Latin America. Companies in the region had been used to responding to a narrower stakeholder universe that presented less demands. They also face far lower possibilities for fiscal relief and government bailouts. To cross through the pandemic, Latin American corporates will have to walk a tightrope, without a safety net to protect them from a fall.

Is balancing survival and solidarity in Latin America a suicidal stunt? Can companies really endure the crisis and meet employee needs and the public's demands for solidarity without government support or the ESG, CSR and stakeholder capitalism capabilities that have taken many years to develop in mature markets?

To address these questions, FTI Consulting's Latin America team:

- Consulted opinion and business leaders from several disciplines to weigh in on whether this corporate balancing act will be successful.
- Reviewed statements and relevant events from the leading publicly traded companies in the region, focusing on Brazil, Mexico, and Colombia, to identify immediate communications and stakeholder management trends emerging from COVID-19 crisis responses.
- Incorporated Mexico and Brazil-specific results from FTI's Shifting Expectations Survey –an initiative to assess how the general public, retail investors and opinion elites are changing their perceptions of businesses and stakeholders based on response to the COVID-19 crisis.

Our findings confirm how precipitous the challenges are. To continue to be productive and retain their increasingly challenged role as valued members of society, corporates will need to bridge the gap that exists between Latin America and developed markets, adopting and adapting best practices – not only regarding efficiency and performance but also in terms of broadening their sensitivity to new stakeholders and growing local community needs. While keeping survival as the priority, companies in the region will need to adopt a progressive corporate mindset, adapt ESG playbooks and develop framework and capabilities that make them responsive to stakeholders in an empathetic, transparent, and objective way. More and more stakeholders are demanding corporate solidarity.

Balancing survival and solidarity –two seemingly competing priorities when resources are limited– will be critical to go through the crisis. It will also be key in upcoming recovery phases. As Susan Segal, president of AS/COA suggests, corporates in Latin America must think of ways to address growing stakeholder demands amid the crisis –regardless of how this effort is labelled. "Governments with large fiscal deficits will find it challenging to cope with some of the necessary measures. The private sector will need to step up in a significant way in Latin America to help support many initiatives. Whether business leaders across the region will do that remains to be seen. Some of them are doing it, and hopefully more will."

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SUSAN SEGAL
President, Americas Society / Council of the Americas (AS/COA)

Latin America's stakeholder capitalism deficit

Companies operating in Latin America have lagged in the adoption of stakeholder capitalism frameworks. Whether it be ESG, traditional corporate social responsibility or proactive stakeholder relationship-building — separate from a company's bottom line or the occasional urgency– corporations across the region face unique cultural and political realities that cloud a comprehensive view of corporate purpose. The sum of these conditions widens a stakeholder capitalism deficit that slows the Latin American business environment's transition toward adopting ESG protocols.

Broadly shared conditions among the region's business environment including weak compliance, high informality and the predominance of family-owned business, SMEs, as well as state-owned enterprises, make robust ESG frameworks a distant reality. As Vanessa Quiroga, director in Credit Suisse's Latin America equity research team put it, "the biggest challenge in Latin America (in this regard) is corporate structure. In most cases, we are dealing with the legacy of generations of family-owned businesses. Generational change should be the most important driver for change here."

Adding to significant ESG framework hurdles found in the corporate structure of Latin American business, the nature of investors looking at the region also contributes to its stakeholder capitalism deficit. Investors beyond the controlling shareholders do not play a major role in shaping, or even nudging corporate purpose and direction. Even mild forms of investor activism are extremely rare, even in the region's leading financial markets. This makes companies less responsive to social issues or to their broader stakeholder group, more generally. Against this backdrop, most Latin American companies center their corporate purpose around either their bottom line or, in some cases, a more primal desire to exert full control over their businesses.

The select cases where commitments to corporate citizenship in leading companies become more visible are usually driven by 'benevolent leaders', as Manuel Molano, executive director of the Mexican Institute for Competitiveness (IMCO), explained. Unfortunately, this scenario relies on personal preferences rather than broad, institutional incentives and demands. Benevolent corporate leaders might be influential role models. But, given they act on individual purpose rather than as a response to the broader environment, their approaches are seldom 'replicated' outside their organizations with the same profundity.

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VANESSA QUIROGA
Director of Equity Research, Credit Suisse

Besides corporate tradition, lack of a firm commitment to rule of law across Latin America has hampered the overall evolution of corporate culture. As Mr. Molano notes, "Domestic companies often opt not to 'modernize' their corporate governance mainly due to the lack of business rule of law. There are major enforceability deficits. This adds to costly compliance outlays imposed by legislation and local authorities, which incentivize informality. This context hinders efforts by bigger, global, companies to adopt sophisticated stakeholder engagement and responsible investing."

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MANUEL MOLANO

Executive director, Mexican Institute for Competitiveness (IMCO)

Because of governance shortcomings in business, culture and governments, stakeholder-oriented decision-making shows a clear lag in Latin American companies when compared to board rooms and financial institutions in developed markets. Mauricio Rosillo, corporate vice president at Grupo Bancolombia, makes note of this delay, while remarking on the possible pressure points that could help businesses across the region bridge the ESG gap: "if we compare Latin America to Europe, Canada, Australia or the U.S., there is a 10 to 15-year gap. However, certain companies are moving quickly. Publicly-listed companies based in the region have started seeing discounts to their share value in cases where there are perceptions of weak corporate governance or high environmental contamination."

Many organizations and governments still see non-market strategies as philanthropic efforts, rather than key operational priorities, crucial to long-term business sustainability. The organizational infrastructure and teams required to deliver consistently on ESG metrics are also typically still absent in Latin American companies. The demand for higher corporate governance standards is effecting change in talent acquisition and the setup of corporate leadership teams, but this is still seen as an emerging trend among leaders, rather than a stable need being addressed proactively by all companies.

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MAURICIO ROSILLO

Corporate VP, Grupo Bancolombia

Larry Rubin, managing partner for Latin America at DHR, points to this trend: "Latin America still lags in ESG, particularly corporate governance, but we are starting to see changes – initially in public companies that have supplier or client-based relationships with other multinational companies. Why? As shareholders start to demand more transparency, they want to see a board room with much more independent stakeholders. Today, people want to work in companies that are responsible in all senses. ESG is exactly what gives employees the firm basis of wanting to work and stay at organizations."

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LARRY RUBIN

Managing partner for Latin America, DHR

Under these conditions, Latin America-focused companies, investors and organizations with robust ESG perspective and protocols are scarce. In their local markets, they often stand out as outliers — not necessarily as leaders showing the way — as the attention of businesses in terms of their public environment is oriented towards regulatory hurdles, business rule of law and enforceability gaps and immediate reputational issues. The balance between survival and solidarity — understood as proactive relationship-building with broader stakeholder groups — is thus tilted towards the former.

Given the region's stakeholder capitalism deficit, forsaking solidarity would leave companies vulnerable to a devastating fall –with no safety net upon which to build future constructive relations with stakeholders.

A shifting paradigm

The COVID-19 crisis is forcing corporations in Latin America into survival mode. But increased demands from employees, governments, media and the public are also compelling them to consider solidarity and corporate citizenship as integral to recovery. Latin American companies face limited access to financial resources. However, according to the Financial Times, "some of Latin America's largest companies (…) have pledged hefty donations to help in the fight against coronavirus." Although many are going above and beyond their typical operations to support employees or communities, this has triggered "criticism from analysts that controversy-prone groups have spotted an opportunity in the crisis to burnish their image."

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ANDRÉS SCHIPANI, BRYAN HARRIS AND JUDE WEBBER
Financial Times

Regardless of whether Latin America's major businesses are seeking redemption for stained corporate reputations or acting out of altruism, attempts to build more constructive relations with governments and their local communities are noteworthy — showcasing corporates understand the reputational and broader long-term risks of not doing so. In this context, many Latin American companies seem to be quite conscious they are walking a tightrope and that there is no safety net.

In Mexico, for instance, FTI's shifting expectations survey shows that 61% of the public and 68% of opinion elites consider companies stand out negatively when they do not take any employee care measures. Consequently, enterprises are likely be criticized if they announce non-cooperative actions such as price gauging, pay cuts and layoffs. In fact, President López Obrador has called out companies with outstanding tax obligations and has threatened to single out companies that undertake layoffs.

COMPANIES STAND OUT NEGATIVELY WHEN THEY DO NOT TAKE ANY MEASURES RELATED TO EMPLOYEE CARE

61% of General Public

68% of Opinion Elites

While companies in Brazil that fail to take comprehensive employee care measures do not stand out nearly as negatively, FTI's shifting expectations survey indicates the stakes have been raised for corporates in terms of their actions and public statements amid this crisis. Namely, 79% of the Brazilian public is paying more attention to the way corporate leaders and CEOs step up to help others in need.

THE NEW NORMAL – FOCUS ON LEADERSHIP

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With a higher-stakes environment triggered by the COVID-19 crisis, Latin American businesses will need to start thinking of constructive relations with the public and key stakeholders as critical for their long-term sustainability. "Companies that fail to adopt responsible investment frameworks will disappear from the market. Consumers themselves will increasingly demand companies to have sustainable practices aligned with ESG," says Luis Fernando Mejía, director at Fedesarrollo.

An overwhelming majority of experts consulted stated that businesses interested in preserving positive reputations before investors and the public must begin to consider the stakeholder landscape as a part of their purpose, especially amid growing social demands from the ongoing COVID-19 crisis.

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LUIS FERNANDO MEJÍA
Director, Fedesarrollo

As Marina Grossi, president of the Brazilian Business Council for Sustainable Development puts it, "this pandemic will help create greater articulation within companies and governments for greater, more effective social impact. What sorts of impact investments will we make from now on? In which areas? How? Are we doing more of the same or are we establishing new priorities? This long-term view must also be adopted by the financial system, so investors do not expect short term returns for long-term-oriented investments. Society must keep pressuring for "purpose capitalism". Companies exist to solve problems and they need to address this as well."

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MARINA GROSSI
President, Brazilian Business Council for Sustainable Development

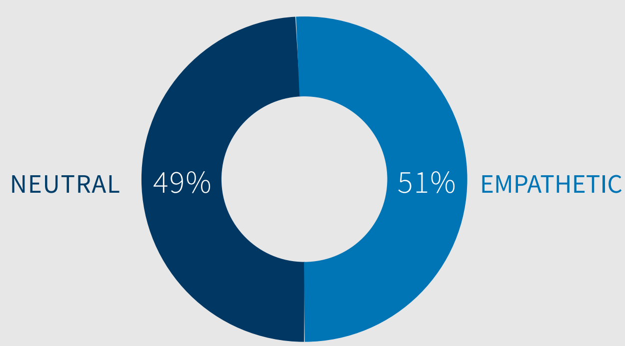
Responding to the crisis under an ESG/SC framework

While companies seem cognizant of the challenging balancing act they face, stakeholder capitalism does not simply require showing empathy. Executing on these impulses requires a set of capabilities that cannot be simply turned on at a moment's notice. A slight majority of leading companies in Brazil, Colombia and Mexico's stock markets have publicly and repeatedly expressed their interest in acting responsibly help to cope with COVID-19. These "empathetic" responses often mention employee, shareholder and social needs.

Company responses in Brazil were disproportionate to Mexico and Colombia — with a higher share of empathetic public statements. Brazil is widely considered as the regional leader on ESG, particularly at the company-level. This is reflected by a greater sense of empathy in corporate responses, as a large majority of firms listed in the Bovespa Index expressed solidarity and detailed actions to step in amid the outbreak.

But, considering the challenges and significant delay for the adoption of stakeholder capitalism frameworks in the region, awareness of the demands has often not translated into decisive action – or even communication. The level of detail and transparency being articulated by numerous companies across Latin America in messaging to different stakeholders — regarding direction, capabilities, and needs — shows that organizations are struggling to adequately think about and address an 'expanded' stakeholder landscape.

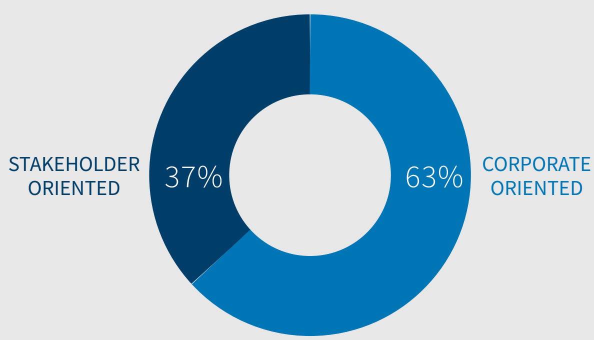
PUBLICLY-LISTED COMPANIES COVID-19 RESPONSE STATEMENTS – MEXICO, BRAZIL AND COLOMBIA



Out of 150 companies across the region that put out empathetic statements, only a minority of them have articulated empathetic messages into responses that go beyond workforce protection and activity updates. Of the 154 companies that communicated empathetic responses, only 37% articulated statements with a sense of social, environmental and ethical purpose appealing to a wider stakeholder landscape. On the other hand, 63% of them issued inward-looking statements aimed mainly at shareholders and employees.

The below graph details the share of listed companies that articulate stakeholder-oriented statements (both outward and inward looking) and needs that other stakeholders might need to fulfill, compared to those with more inward-looking responses — where corporate considerations take priority.

ESG PURPOSE IN COVID-19 RESPONSE STATEMENTS – MEXICO, BRAZIL AND COLOMBIA



There are limitations for Latin American companies in terms of sensibly addressing the whole stakeholder ecosystem, while incorporating some sort of ESG mindset into their messaging. The current context narrows the strategic options for most companies in the region, forcing them to make decisions in more binary ways without considering how the broader stakeholder universe might complement their efforts. Adding to the financial and operational challenges they might face, this challenging scenario to articulate corporate purpose exposes companies to reputational risks among the public and decision-makers.

*A combined sample of over **300 company responses** in Brazil, Colombia and Mexico was analyzed. We weighed official responses empathetic of the public and employees, against internal responses or public statements limited exclusively to announcements on compliance with safety measures and operational plans. **51% of companies** assessed **proactively put out empathetic statements on their COVID-19 response actions and considerations**.*

NO TIME TO WAIT – TAKE ACTION

51%

of companies assessed proactively put out empathetic statements on their COVID-19 response actions and considerations

This coding methodology — split into empathetic and neutral responses — considered official communications in the stock exchange and public declaration by executives. The determination between both categories was made by measuring the use of words like "solidarity", "community", "healthcare professionals" and others that demonstrate a sense of higher responsibility towards the public ecosystem.

FOCUS ON KEY TERMS – SENTIMENT MAPPING

Moving past the crisis

The crisis has made it clear that businesses in the region must strive to integrate communicate stakeholder identification, monitoring and engagement capabilities. The quicker companies can do this — preferably in a way that articulates corporate purpose vis-à-vis the stakeholder universe — the better positioned they will be to efficiently convey their external value proposition.

Companies that intend to lead through the crisis and come out with stronger relationships with stakeholder groups cannot remain oblivious to this.

Rosario Córdoba, director of Colombia's Private Competitiveness Council, suggests that although economic hardship will make ESG hard to materialize in Latin America anytime soon, current conditions are driving businesses to think more about their stakeholders. "Post Covid conditions will be survival-focused. However, Covid will be a great lesson: if companies want to operate in these circumstances, they will have to be increasingly conscious of their external environment and the need for better relations."

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ROSARIO CÓRDOBA
Director, Private Competitiveness Council of Colombia (CPC)

Rosario Córdoba also argued that in Colombia there have been significant exceptions to the survival-focused measures taken by companies. Various companies included in the Dow Jones Sustainability Index are the ones which have mainly marked a difference in the Colombian corporate culture.

According to FTI's Shifting Expectations survey, the public is currently more alert about companies' efforts to step up in help of their customers, employees and society in general. Also, of note, opinion elites and regular Brazilians and Mexicans with extreme COVID-19 concerns are paying closer attention to these actions.

"Stakeholder capitalism can be a differentiating factor for the most sophisticated companies and investors amid COVID-19 (…). Further articulating and publicizing ESG narratives could highlight the competitive advantages of surviving companies. Unfortunately, we are not there yet (in Mexico and Latin America)."

JOSÉ VICTOR TORRES
Partner and founder of the Finance and Banking Practice, González Calvillo

The public's eyes are on Latin American corporates — who simultaneously deal with the burden of surviving this crisis. Meanwhile, the sizable ESG lag that has put the region behind on being responsive to stakeholders through ESG protocols remains. As José Victor Torres, partner and founder of the Finance and Banking Practice at González Calvillo points out, "stakeholder capitalism can be a differentiating factor for the most sophisticated companies and investors amid COVID-19 — particularly for those that can articulate narratives allowing them to attract attention from long-term investors in the current context. Further articulating and publicizing ESG narratives could highlight the competitive advantages of surviving companies." However, he also points out that while the area of opportunity exists, the reality on the ground should make us weary of wishful thinking. "Unfortunately, we are not there yet (in Mexico and Latin America)."

If businesses across Latin America are to secure their 'freedom to operate' in the current crisis and its aftermaths, they must generate more confidence than ever in their assets and business practices. Publicly articulating ESG initiatives and ample contributions to the sustainability of local communities will play a key role in securing this confidence. Especially as stakeholder demands for responsible business response grow.

"Two distinct groups of companies will emerge from this crisis: 1) those that will continue to integrate stakeholder engagement initiatives as a part of business strategy, and 2) those that will focus on their survival and likely limit their ESG agenda (…). The current crisis might accentuate the existing disparities."

GUSTAVO PIMENTEL
Managing director, SITAWI – Finance for Good

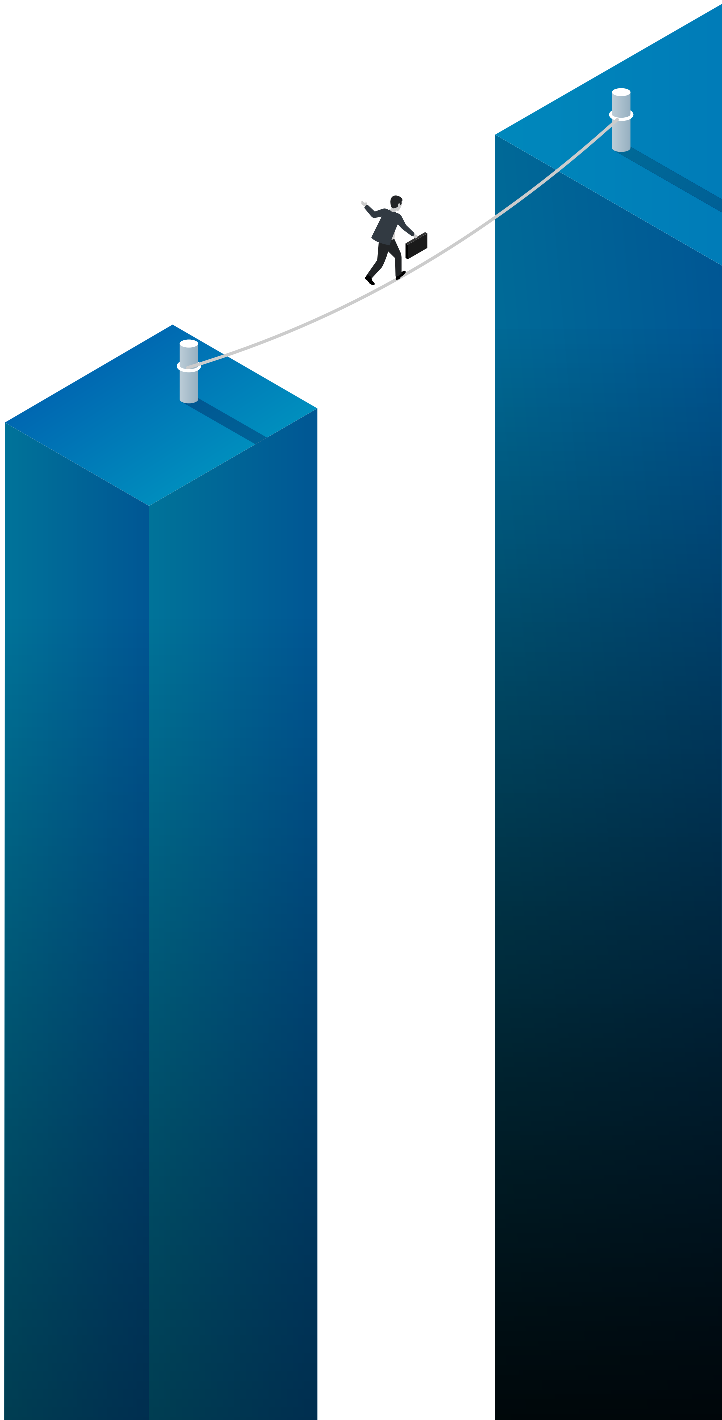
Gustavo Pimentel, managing director at SITAWI – Finance for Good, gives us a vision of how businesses could diverge amid COVID-19. "Two distinct groups of companies will emerge from this crisis: 1) those that will continue to integrate stakeholder engagement initiatives as a part of business strategy, and 2) those that will focus on their survival and likely limit their ESG agenda, particularly initiatives related to the "E" and "S" dimensions. The current crisis might accentuate the existing disparities — it will also be a test for the new generation of Brazilian and Latin American ESG investors."

Conclusion

A stakeholder-oriented communications opportunity

Corporates have a fiduciary responsibility: they are no good if businesses do not survive. But, with more voices participating in the public sphere — whether through more incisive media, the scrutiny of organized civil society, or through politicians adopting a critical view of business in general — companies should not lose sight of the broader public sphere, particularly of the needs and demands of other stakeholders. Stakeholders are unequivocally more numerous and vociferous now.

Latin American corporates walking the tightrope through this crisis face existential risks. Should they focus solely on solidarity and lose their balance, economic hardships could end their businesses. But survival cannot remain their only priority, as the expectations of what a company should stand for in the region are changing quickly and growing demands from stakeholders are pressuring businesses to take purpose-oriented actions. Against this backdrop, many questions remain unanswered. Will Latin America really emerge from the crisis with a new breed of more conscious companies? Can governments and corporations jointly address the barriers to a robust ESG environment? Will primary investors in the region help corporations take that step? The answers will determine the future of stakeholder capitalism in Latin America — a region much in need of a change in perceptions of what a business's purpose is.



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