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Getting the right balance between profits and stakeholder needs

Introduction

Compared with other financial markets across the globe, the domestic Australian investment community is relatively small, albeit one which is reasonably well established and sophisticated. This has led to the domestic investment landscape being a somewhat inter-dependent and delicately balanced ecosystem. Many Australian listed companies depend on the publicly traded markets as a source of originating or expansion capital. Many retail investors depend on those companies and their sustainable financial performance as a source of wealth creation and retirement funding plans. The role of regulators is also critical in providing and policing a fair and transparent and consistent set of rules for all market participants.

However, a sole focus on the operation and benefits associated with financial markets can often ignore the needs of other business stakeholders, who must ultimately be considered for the longer-term sustainability of companies, their financial performance and their investment returns.

The Importance of Balancing the Reasonable Expectations of Stakeholders

Companies operate within a landscape containing a range of internal and external stakeholders, including customers, employees, investors, communities, suppliers and regulators. Balancing the reasonable expectations of these stakeholders is crucial for a company's sustainable growth, long-term profitability, and the maintenance of a positive corporate reputation. Failing to do so can lead to financial instability, loss of consumer trust, and regulatory scrutiny, none of which is beneficial for the company or its investors.

The Role of Stakeholders in Business Success

Stakeholders are individuals or groups who have an interest in or are affected by a company's operations. Each stakeholder group often has different expectations and priorities, including reasonable remuneration, fair trading terms, consistent quality of services or goods, clear communication and ethical corporate behaviour. Companies that can align their operations with these diverse interests are often in a position to create a foundation for long-term business and financial success.

The Role of Profits in Business Success

Just as it is non-sensical for a company to ignore non-investor stakeholders in the conduct of its business, it is equal folly for companies to ignore their profit-making objectives. Indeed, the two objectives need not be mutually exclusive, and should ideally operate in harmony. Without running a profitable operation, companies cannot:

- Employ people on fair terms;
- Pay investment returns to its shareholders;
- Re-invest in their businesses to meet evolving customer needs;
- Provide a sense of long-term surety to customers, suppliers and investors;
- Make broader financial and non-financial contributions to the community;
- Engage with suppliers on fair terms;
- Attract new talent and new investors.

Thus, companies are faced with the on-going challenge of balancing their profit-making objectives with the broader needs and evolving requirements of other stakeholders relevant to both its shorter-term reputation and its longer-term sustainability.

Benefits of Balancing Stakeholder Needs

Investors should be mindful of the fact that progressive Boards are constantly trying to balance the reasonable expectations of their company's various stakeholders, in pursuit of the following benefits:

- Enhanced corporate reputation, brand image and trust;
- Improved employee engagement and productivity;
- Stronger and more sustained financial performance;
- Regulatory compliance and risk management benefits;
- Sustainable growth and longer-term competitive advantages.

Questions for Retail Investors

While investors are invariably focussed on the financial performance metrics of companies as part of their wealth creation and retirement funding strategies, a number of ancillary questions might be considered in relation to the company and its range of other stakeholders:

- How is the company governed and managed? Do the Board and management appear to consider the long-term implications of their business decisions, not just the short-term financial benefits?
- How does the company deal with its stakeholders including not only its shareholders, but its customers, its workforce, the community in which it operates, its suppliers, etc? On balance, are the dealings fair and ethical, or is the company exploitative in its approach?
- Are the company's business practices sustainable, or will they disenfranchise customers, its workforce, the community and / or its suppliers by the way in which it conducts its business?
- What is the regulatory track-record of the company and its Board members? Is the company being scrutinised by the like of ASIC, ASX, ACCC, etc? Do the Board members have a sound track record, or have there been past issues with regulators?
- Reputationally, how is the company viewed by the community as a whole? Is the company (and its Board) seen as taking responsibility for its decisions and its actions, or is it attempting to dodge that responsibility (think the infamous "bundle of rights" air ticket incident, or the charging of deceased customers practices)?
- Is the company considered progressive in relation to its broader environmental and community-related responsibilities?

Expectations of Companies we Monitor

Whilst we primarily measure and examine the financial performance of the companies we monitor, we also expect listed Australian companies to abide by the letter and spirit of the ASX Listing Rules, together with other laws and regulations as relevant to the company, particularly including Australia's Corporations Act. Companies we monitor are expected to have considered the issues raised in this paper, which underpin the common principles of accountability, transparency, fairness and responsibility. We expect companies to engage fairly in all aspects of their operations, and treat their broad range of stakeholders with sensitivity and respect.