Moral bankruptcy during times of crisis: H&M just thought twice before triggering force majeure clauses with suppliers, and here's why you should too

Anna Triponel and John Sherman

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COVID-19 is forcing companies to make tough business decisions. But they cannot declare moral bankruptcy and expect to emerge unscathed from the pandemic. By reflexively triggering force majeure clauses to halt payments to suppliers with vulnerable workers, including for orders already processed, companies risk losing their social license to operate.

World economies are in free fall. Estimates for the UK are between a 15 and 24 per cent drop in the size of the UK economy; a 24 per cent drop is anticipated in the United States. Sales at fashion house Burberry are down by 50%, which could increase to 80%; while four weeks of shut stores will cost fashion chain Primark £190m of revenues, with the number increasing daily as lockdowns continue.

Companies are hurriedly looking for ways to stop bleeding cash. Beyond fashion and retail, we are seeing this the most starkly in transportation, tourism, hospitality, entertainment, and some consumer goods companies. Companies – large and small – are focused on business survival. Strategies to protect cash flow include reducing overheads, reducing payroll costs, expediting the collection of cash from debtors, cancelling supplier orders, and lengthening payment terms with suppliers. Some companies are asking their lawyers to trigger force majeure clauses in their contracts, to avoid paying suppliers for orders they have already produced.

But this strategy comes at a high human cost. In lower-income countries, suppliers already have low cash reserves and little access to credit. They have already paid for wages and materials on these past orders. When combined with the future loss of business, cancelling past orders will be enough to put many of them out of business. Workers will be let go overnight, some without wages or severance, many of which support households, lack savings, and have no access to a governmental social safety net. A large number of the 150 million workers in low-income countries producing goods for the west will be impacted by these factory closures, with 4 million alone in apparel in Bangladesh.

It doesn't have to be this way. This week, fashion giant H&M announced that it would take delivery of already produced garments, as well as goods in production, and that the goods would be paid for under previously agreed payment terms and prices. Other ways we are hearing apparel companies integrate a people lens into cash flow decisions include protecting specific suppliers in countries where workers lack a social safety net or seeking to only exercise force majeure with suppliers that have the financial wherewithal, rather than necessarily those suppliers that offer the most savings. In the fast-moving consumer goods space, L'Oréal is prioritising immediate payments to and shortening payment terms with suppliers who may go out of business, and Unilever is offering early payment to its most vulnerable small and medium-sized suppliers to help them with financial liquidity.

In the post-pandemic world, companies will be judged by how humanely they handled this crisis. This will include not only how they treated their direct employees, but also whether they took appropriate steps to mitigate the impact on the most vulnerable workers in their value chain.

In order to keep their social licenses after the pandemic, companies should consider the ability of their suppliers to survive a force majeure provision being triggered. Companies should assess the pre-existing vulnerability of supply chain workers who would be laid off, and whether they will have an adequate social safety net and benefit from tailored fiscal support. And they should advocate collectively with their peers to press governments to strengthen that safety net.

To quote one old business saying, 'When you're up to your neck in alligators, it's hard to remember that the initial objective was to drain the swamp.' Obviously it is challenging for companies to factor human impact considerations into their immediate responses to a crisis. But things won't be the same after the pandemic is over, and companies will not be judged by the same standards. The old winner-takes-all business model was already being challenged, as seen by the skyrocketing use by investors of ESG (Environmental, Social and Governance) factors in their decision-making, where the "S" stands for social impact). The pandemic will likely hasten that model's demise.

Decisions made today that protect cash flow by not paying suppliers, without regard to harm to their workers will be costly. 195 investors representing over $4.7 trillion USD in assets under management have sent the message that companies should maintain timely, or prompt, payments to suppliers. Governments may choose to limit financial support to companies that did not behave responsibility. Recent laws that compel companies to consider their impacts on people in the full value chain are likely to be used to sue companies to hold them accountable for the harm, and shame them for not behaving responsibly. A distinction will be made between those companies that reduced future orders to weather the storm, together in discussions with suppliers, and those that used force majeure to pull the plug on past payments due.

Companies will be unable to argue that they didn't know. Just in the last week, associations representing suppliers in Bangladesh, Cambodia and India have issued urgent pleas to buyers to request that they pay for goods already produced and take steps moving forward to mitigate the impacts of their decisions on the livelihood of millions of workers. And companies themselves had previously embraced operating for the benefit of all stakeholders – including their suppliers and communities.

After the pandemic, the short term need to maintain positive cash flow will not excuse a company's decision to ignore human rights harm to supply chain workers. The decision to exercise a force majeure clause to cancel supplier payments for past orders is not a simple on-off switch, to be toggled reflexively. Just because a company can exercise force majeure doesn't mean that it should. Its future social license to operate may be at stake.

Anna Triponel is a business and human rights advisor and former consultant with the Harvard Kennedy School of Government to develop the 2011 UN Guiding Principles on Business and Human Rights. John Sherman is a Senior Program Fellow at the Corporate Responsibility Initiative at the Harvard Kennedy School, an Executive Fellow at the Hoffman Center for Business Ethics at Bentley University, and Senior Advisor and General Counsel of Shift. The views expressed here are the authors' own and not those of any entity with which they are or have been affiliated.