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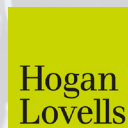
Report

IS LEGISLATION THE BEST WAY TO ACHIEVE STAKEHOLDER CAPITALISM?

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In partnership with:



REPORT

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This report summarises research carried out by Hogan Lovells and Business in the Community (BITC), in partnership with the Better Business Act (BBA), to understand how proposed changes to legislation could lead to greater stakeholder accountability for businesses as well as the barriers to this approach.

INTRODUCTION

Business in the Community (BITC) and Hogan Lovells carried out a piece of research to understand what steps businesses have taken to embed purpose and multi-stakeholder accountability in their businesses. As well as highlighting best practice, the research sought to understand how and if business leaders believe that the changes to Section 172 of the Companies Act 2006 proposed by The [Better Business Act \(BBA\) campaign](#), could empower directors of UK companies to lead their organisations to play a part in creating a cleaner, greener, fairer future for all. Additionally, it explored any potential concerns about the changes.

BITC would like to thank Hogan Lovells, BaSE and the Better Business Act for their research and contribution to this report.



The first of the British Academy's Principles for Purposeful Business is that '*Corporate law should place purpose at the heart of the corporation and require directors to state their purposes and demonstrate commitment to them*'.ⁱ A legislative approach would not be without precedent. In the US, designation as a public benefit corporation enables a company to pursue a social or environmental mission in tandem with commercial success and sustainability.

In terms of accountability, a public benefit corporation is then audited against its stated mission and required to report on its progress. In France, purpose-led companies wishing to legally enshrine a triple bottom line approach can become an *Entreprise* or *Société à Mission*. For example, Danone became the first publicly listed company to adopt the structure, embedding its social and environmental purpose in its bylaws and establishing a 'mission committee', that holds it accountable to that purpose.ⁱⁱ



“BENEFIT CORPORATION LEGISLATION CREATES THE LEGAL FRAMEWORK TO ENABLE MISSION-DRIVEN COMPANIES LIKE PATAGONIA TO STAY MISSION-DRIVEN THROUGH SUCCESSION, CAPITAL RAISES, AND EVEN CHANGES IN OWNERSHIP BY INSTITUTIONALISING THE VALUES, CULTURE, PROCESSES AND HIGH STANDARDS PUT IN PLACE BY FOUNDING ENTREPRENEURS”ⁱⁱⁱ

Yvon Chouinard, Patagonia founder

In the UK, a legislative approach has also been proposed by ShareAction in relation to the duties of those managing and investing money. They have proposed a Responsible Investment Bill which sets out a vision for a clearer and stronger role for ‘fiduciary investors’ within society and the economy.^{iv}

This approach is complementary to the approach put forward by the BBA and supports a multi-stakeholder view from investors whilst the BBA promotes this view from Directors. Taking a two-pronged approach with investors and directors will be the way to make progress on this issue, as business leaders won’t be incentivised to think in this way without support from investors.

The UK Corporate Governance Code and the Financial Reporting Council’s (FRC) Stewardship Code 2020 recognise a purpose beyond profit. For example, the Stewardship Code 2020, which is voluntary, sets good stewardship practice for those investing money on behalf of UK savers and pensioners and takes account of Environmental, Social, Government (ESG) considerations. This is achieved by, for example, requiring signatories to evidence their stewardship activities and show how they integrate ESG factors into investment decisions. The Institute of Directors has proposed a voluntary code of conduct for UK directors to saying that ‘*The behaviour of directors is just as important for society as the behaviour of doctors, lawyers, accountants, and other professionals.*’^v

There is an argument to say that corporate law should be updated to reflect an environment in

which the market expectation and corporate practice already acknowledge the role of stakeholder accountability.

However, this same argument is used by those who say legislative change is not necessary because corporates can already embrace stakeholder capitalism if they wish. Under current UK company law, purpose-led organisations can amend their constitution to include a purpose statement and additional directors’ duties to pursue that purpose, as organisations such as Anglian Water have shown.

So, some will ask, is there a need for legislative change? In terms of mechanisms for change, legislation has the benefit of being a wide net, if the legislation were updated to encompass stakeholder accountability, it would apply to the entire market and set a common baseline for all corporates. Whilst directors’ duties under current UK company law may not always be perceived as a barrier to purpose-led business, they are sometimes used as a shield for those pursuing profit at the cost of other stakeholders. As we have seen from companies such as P&O, shareholder primacy and commercial success is used to justify actions that negatively impact other stakeholders.

Legislative change is also a means of instigating long-term change. Whilst companies are left to their own devices in terms of stakeholder accountability, there is always a risk that any move in that direction could be reversed by new owners or investors with a different approach.

WHAT IS THE BBA?

better business act The BBA is a campaign to amend Section 172 of the Companies Act 2006 so that companies are legally obligated to operate in a manner that benefits their stakeholders, including workers, customers, communities, and the environment, while seeking to deliver profits for shareholders. The campaign was started by B Lab UK and the BBA coalition currently consists of over 1,500 businesses – businesses who support of the proposed changes to the Companies Act.

Whilst purpose-led organisations can amend their constitution to include a purpose statement and have additional directors' duties to pursue that purpose, the idea of the BBA is that it would be the starting point for all businesses. Boards would still focus on commercial success for shareholders – but via a strategy that takes account of wider stakeholder issues.

The BBA advocates that by empowering all directors to exercise their judgement in weighing up and advancing the interests of all stakeholders it will change the nature of conversations in the boardroom, allowing for a more holistic approach to the challenges faced by company directors. For many businesses this will be a formalisation of current behaviour and would support their intention to take ownership of their social and environmental impacts.

OUR RESEARCH

Participants were invited to review a series of high-level questions in advance of an interview with representatives from Hogan Lovells about what their company is doing to embed purpose and a multi-stakeholder approach at a practical level and about their thoughts on the BBA's proposed amends to the Companies Act and what that would mean for their organisation.

The purpose of the research was to:

- develop company understanding of the BBA's campaign to amend Section 172 Companies Act 2006
- gather an understanding of the perceived implications of the BBA for UK business leaders
- collate and highlight practical examples of organisations that have implemented a purpose-led or multi-stakeholder model of business.

Hogan Lovells interviewed 15 participants from a range of sectors and the conclusions of those interviews are set out below.

It should be noted that whilst the majority of those interviewed represented limited companies (both private and public), interviews were also conducted with representatives of three LLPs and a UK based charity, to whom the BBA would not apply. The interviewees themselves held a variety of roles within these organisations, from heads of sustainability teams, general counsel and members of boards of the organisations represented. The interviews were conducted on condition of anonymity in order to encourage the free sharing of information and experience.



INTERVIEW CONCLUSIONS

GENERAL POINTS

All of the interviewees expressed support for stakeholder accountability and purpose-led business. The extent to which they had already or intended to embed purpose and stakeholder accountability into the strategy and management of the organisation varied.

The question of purpose and stakeholder accountability is incredibly topical. This was reflected in the fact that the conversation was high on the agenda for all of the organisations that we spoke to. Two of the fourteen were in the process of reviewing and reframing their purpose.

Some interviewees saw these issues as being about values and culture rather than commercial decision making. In many cases the sector or industry in which an organisation operates in has a bearing on how formalised its stakeholder governance structures are. For example, there is an expectation that regulated industries such as utility service providers adopt elements of stakeholder governance as a minimum. This market-driven impetus is also apparent in organisations that provide services to government who are evolving new models of stakeholder accountability in order to meet social value procurement obligations.

MEANING AND APPLICATION OF PURPOSE

Interviewees identified a lack of consistency in the terminology around these issues and there were differing approaches to what corporate purpose and stakeholder accountability mean in practice. Some organisations perceive purpose and stakeholder accountability to be questions of corporate value, which are achieved primarily through the organisation pursuing a positive corporate culture, for example by ensuring that all employees embed a company's environmental values in their day-to-day work. Some suggested that you are more likely to make change by embedding a culture and a way of doing things

than through KPIs and targets which could be seen as a 'tick box exercise'.

“PURPOSE CAN BE A PROBLEMATIC BLEND OF SUBSTANCE AND ALSO MARKETING AND WHAT MAKES YOUR UNIQUE IMPRESSION ON THE WORLD”

Research interviewee

The great majority of organisations interviewed had a clear and public statement of corporate purpose. However most of these organisations had not included their corporate purpose in their governing documents but had embedded it in nonconstitutional ways such as codes of conduct, employee pledges, websites, social media and other internal and external marketing materials.

Participants who define their purpose in their constitution stated that doing so showed others, particularly customers, employees and investors, very clearly what their organisation stood for. They were motivated by publicly making a legal commitment to their purpose and by the protection that that offered against mission drift over time. Typically these organisations also included additional wording in their constitution to ensure that directors had a duty to pursue the stated purpose.

“WE WANTED TO NAIL OUR COLOURS TO THE MAST. THIS ALSO HELPED PROTECT THOSE VALUES GOING FORWARD, PARTICULARLY IF WE CHANGED OUR INVESTORS”

Research interviewee

Six interviewees noted that their organisation's purpose permeated everything that the organisation did, with one noting *‘the way we talk about everything at the moment, whether in the news or internally, we tie that back to our purpose and values and try and make it applicable to everybody.’* These participants felt that across the organisation there was a consistency of understanding around corporate purpose and what that meant for stakeholders.

These same organisations believed that their organisations' purpose guided its core business strategy and commercial decisions. Their boards ensured that a wide range of stakeholders were considered when making decisions, ranging from the environment to employees, as well as profits. For example, the company evaluated and remunerated employees based on the fulfilment of the organisation's purpose or for the attainment of specific ESG related targets. Other interviewees ensured that suppliers also reflected the organisations' own purposes, and/or were working to their own ESG related targets.

Where relevant, the boards of participant organisations were compliant with their statutory duties in relation to section 172 (1) Companies Act 2006 and the requirement to produce a 172 (1) statement in the strategic report which describes how the directors have had regard to the matters set out in section 172 (1) (a) to (f) when performing their duty under section 172.

Two interviewees noted that it could be difficult to ensure that their organisations' purpose was consistently applied across multiple jurisdictions, offices and teams. They reflected that their organisations' purpose could be interpreted or defined differently depending on the jurisdiction, making it harder to define a purpose that was equally applicable across the entire business.

One interviewee cited the need for increased employee engagement to tackle consistency of use of purpose and understanding of stakeholder accountability across employees working in different contexts (for example office-based versus site-based).

LEGISLATION AS A MECHANISM FOR CHANGE

There was broad agreement that legislative change could be a means of speeding up the adoption of stakeholder accountability.

Organisations that had already embedded stakeholder accountability into the core of their business felt that further regulation could help others move in the same direction. There was agreement that it would be a good way to level the playing field in terms of ensuring that all businesses adopt a greater level of stakeholder governance. These organisations thought that a statutory obligation to embed purpose and stakeholder accountability constitutionally was the best way to protect a purpose-led approach for the long term. It may also prevent companies using shareholder primacy as justification for actions that negatively impact other stakeholders such as employees or the environment.

Most interviewees who supported the idea of introducing legislative changes to create greater stakeholder responsibility also believed that their shareholders and investors would be supportive of the initiative, although some noted that it might depend on the nature and strategy of the particular investor.



Some interviewees felt that in order for legislation to be an effective mechanism for increasing stakeholder accountability it needed to have ‘teeth’ (i.e., the consequences of non-compliance are clear and sufficiently disincentivising). There was also a suggestion that UK legislation alone would not be sufficient, and that an EU-wide or global approach was required for real change to occur. Others voiced a concern that imposing these changes through legislation could be treated as a ‘tick box exercise’ for companies rather than an authentic adoption of stakeholder governance.

One emerging theme amongst interviewees was the importance of clarity for boards of directors. Some organisations felt that shareholder primacy offered boards a clear basis for decision making and any steps to change this from a legislative perspective would need to maintain that clarity. One interviewee expressed a concern that legislating for stakeholder accountability would increase the responsibilities imposed on directors and potentially discourage people from becoming directors.

The majority of interviewees did not feel that their boards were constrained by the current focus of directors’ duties under the Companies Act 2006. To the extent of their knowledge they believed that their boards felt free to consider a broad range of stakeholder issues when taking decisions. They therefore saw the value of legislative change not as a shield for boards who already taking stakeholders into account but as a means of bringing models of stakeholder governance to every company.

In contrast one interviewee argued that boards were in fact constrained by the current wording of s.172 of the Companies Act, which they felt was outdated in the current market. They argued that shareholder primacy does more harm than good and, if exclusively used, serves the executive (and, in particular, their legacy and bonuses) and not shareholders.

A number of interviewees, particularly those representing ‘client facing’ industries took the view that the market, not legislation, was the best

mechanism for change and were led by the willingness of their clients to adopt a more purposeful approach to business.

“LAW WILL NOT MAKE THE DIFFERENCE. WHAT MAKES THE DIFFERENCE IS CHANGES IN GLOBAL ATTITUDES”

Research interviewee

As a counter to that view, another interviewee suggested that the increasing role of ESG in the market was not going far enough.

“YOU CAN’T LEAVE IT TO THE MARKET AND WE ALREADY KNOW THAT. WE WILL NOT BE SEEING BUSINESSES DOING WHAT THEY MUST UNLESS WE HAVE A CARROT AND A STICK BECAUSE EVEN WITH NET ZERO TARGETS, THERE IS NO HOPE OF THAT HAPPENING UNLESS THERE IS MANDATORY CHANGE”

Research interviewee



MULTINATIONALS

A participant reported that its non-UK based parent company benefitted from the UK subsidiary's adoption of a purpose-led and stakeholder governance approach as it enabled it to associate itself with developments in this space that were not always legally available in other jurisdictions. The interviewee believed that advances in the UK's approach to stakeholder accountability enabled multinationals with a presence in the UK to benefit, for example in terms of reputation, by association with leadership and innovation in the space. They also suggested that due to a 'generational shift' occurring in other jurisdictions, whereby stakeholder accountability and purpose will become far more important in doing business, UK subsidiaries are well placed to support in this transition.

One interviewee raised a concern that legislative changes could exacerbate post-Brexit challenges in attracting investment to the UK. They wondered if additional obligations for the boards of UK subsidiaries could make the UK less competitive with European counterparts.

The need for clarity and understanding was echoed by multinational participants. Interviewees reported different levels of understanding of stakeholder accountability outside of the UK. One interviewee pointed out that global companies need to have a consistent constitutional approach, and there was a perception that differing legislative obligations around stakeholder governance could be difficult to manage.

Most of the interviewees representing multinationals believed that the greater the jurisdictional scope of the obligations the easier it would be for them to adopt.

BETTER BUSINESS ACT

Three of the 15 organisations were signatories to the BBA. Three further organisations were not incorporated as companies and would therefore not be directly impacted by the proposed changes to company law.

Signatories to the BBA saw it as an opportunity to show themselves to be leaders in the field of stakeholder governance. They did not necessarily believe that the proposed changes to the Companies Act would have a large impact on the way their organisation operated, but they thought it was a necessary means of ensuring that that conversations around stakeholder accountability were a component of all board decision making for every company. It was felt that the BBA was a means to level the playing field.

Beyond those interviewees who were already signatories to the BBA, there was not a high level of awareness of the campaign. Several had become aware of the BBA through the research project. In some organisations it was familiar to responsible business or sustainability specialists within the business but not always amongst the C-suite.

The majority of interviewees were supportive of the BBA's mission. There was support for legislation that added clarity to the terminology around purpose and stakeholder accountability. One interviewee believed that the BBA might help people engage more effectively and come to properly understand the meaning of purpose in a business context. Another interviewee argued that the BBA could help *'people understand that (i) this is nothing new, and (ii) this is the only way the free market can work.'*

All of the interviewees welcomed any proposed clarification around reporting against purpose and stakeholder accountability. It was perceived that clarity was key to the success of the proposed amendment. One interviewee expressed a concern that the proposed amends could lead to a lack of clarity for directors by bringing parity between competing interests. They suggested that the BBA changes could make decision making harder for directors. Another interviewee thought that the campaign name was misleading as it suggested the introduction of a new Act rather than an amendment to the existing Companies Act.

CONCLUSION

Corporate purpose often hinges on the positive impact that a company might have through its operations. However, to have a complete picture of a businesses' impact you also have to consider its negative (or even just 'not-positive') impact.

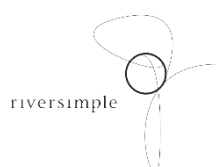
The idea of a 'netpositive' company is one that gives more to the world than it takes and aligns with the idea that it's no longer enough to be net zero, we need to adopt a regenerative mindset.

In terms of stakeholder accountability this requires a more holistic approach that encompasses all business activities rather than a CSR approach that looks at sustainability and impact as something separated from core business. Stakeholder accountability works best when a company is positioned in such a way that its success is a good thing for all of its stakeholders. When stakeholder interests are aligned, companies are in a strong position to ensure business resilience and sustainability for the long term.



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BITC and Hogan Lovells would like to thank the following companies for taking part in this research, in addition to two other organisations who wished not to be named:



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ENDNOTES

ⁱ The British Academy (2019), *Principles for Purposeful Business*, available at: <https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/>

ⁱⁱ Danone, *Danone's strategic framework – from the 'dual project' to 'societe a mission'*, available at: <https://www.danone.com/about-danone/sustainable-value-creation/danone-societe-a-mission.html>

ⁱⁱⁱ Patagonia, *Benefit Corporation Update: Patagonia passes B Impact Assessment, improve score to 116*, available at: <https://eu.patagonia.com/gr/en/stories/benefit-corporation-update-patagonia-passes-b-impact-assessment-improves-score-to-116/story-17871.html>

^{iv} ShareAction (2020), *Responsible Investment Bill: the change we need*, available at: <https://shareaction.org/policies/responsible-investment-bill-the-change-we-need>

^v Institute of Directors (2022), *A Voluntary Code of Conduct for Directors*, available at: <https://www.iod.com/news/governance/iod-policy-paper-a-voluntary-code-of-conduct-for-directors>