The Prince's Responsible Business Network

Celebrating 40 Years

Toolkit

STAKEHOLDER CAPITALISM: FOUR TIPS TO FUTUREPROOF YOUR BUSINESS

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In partnership with:

Hogan Lovells

BaSE
BUSINESS & SUSTAINABLE ENTERPRISE

The Prince's Responsible Business Network

TOOLKIT

STAKEHOLDER CAPITALISM: FOUR TIPS TO FUTUREPROOF YOUR BUSINESS

This toolkit, written in partnership with Hogan Lovells, outlines the different methods that companies can use to embed stakeholder accountability through various corporate governance structures.

INTRODUCTION

When it comes to corporate purpose and Environment, Social, Governance (ESG), the competition is on for who can make the biggest splash. For stakeholders, it can be a challenge to see through the noise. Stakeholders have a role in ensuring that any commitments are not a question of style over substance, and they are increasingly able to hold businesses to account.

For some, the 'purpose journey' is a little like learning to swim. You have corporate purpose in the shallow end, a necessary starting point but easy to touch the bottom when you think no one is watching. On gaining confidence, a business may venture into the deeper waters of stakeholder accountability.

True accountability leaves no room for cheating and requires new skills to stay afloat. The deep end of ESG is often framed in terms of business risk but for those who learn to swim, the opportunities are clear. From a sustainability perspective we need every business swimming in the deep end.

Corporate purpose has its role, it can act as a north star and as a tool to communicate, but since the new wave of corporate purpose has ushered in the age of ESG – has anything really changed?

What are the levers that make a measurable difference? How do you turn corporate purpose into change that moves the dial on the intractable global issues that we all face? Is stakeholder accountability and corporate purpose all grown up?

BITC would like to thank Hogan Lovells and BaSE for their research and contribution to this report.

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THE PROBLEM – SHARKS IN THE WATER

We can all agree on the problems – a climate emergency, widening inequality thrown into relief by a global pandemic, conflict, and a lack of racial justice, just to name a few. These issues can seem detached from the day-to-day of a business, but every business is made up of people - operating in communities and using resources. Thus, these groups are all its stakeholders.

Failing to acknowledge the interdependence of business and its stakeholders is not a sustainable business strategy. The consumer stakeholder group is perhaps the most obviously impactful to a company's commercial success.

ULTIMATELY, YOU CANNOT HAVE INFINITE GROWTH ON A FINITE PLANET. AND ANYTHING YOU CAN'T DO FOREVER IS BY DEFINITION UNSUSTAINABLE[i]

Paul Polman, Ex-Unilever CEO

3 in 5

consumers will boycott brands in the next year that do not act on climate change[ii]

Consumer expectations are often mirrored by employee expectations. Employee activism on issues such as climate change is increasingly common. A recent report found that there is often a perception gap between what C-suite leaders say they prioritise in terms of climate change and what employees perceive they are to be doing.[iii]

For instance, 73% of leaders say they put the same importance on sustainability as they do on profits but fewer than half of employees surveyed believed that to be true. This gap highlights the importance of a need not only to implement corporate purpose but also to ensure that implementation is embedded in a transparent manner so that every stakeholder can see what is being done.[iv]

The environment is a key stakeholder, and it too has the power to have a dramatic impact on a company's bottom line. As well as bringing devastation to thousands (the World Health Organization estimates that global warming will contribute to an additional 250,000 deaths annually between 2030 and 2050[v]) it's clear that climate change is bad for business. The World Economic Forum reports that $44 trillion of economic value generation, equal to more than half of the world's total Gross Domestic Product (GDP), is potentially at risk because of business dependence on nature and its services.[vi]

We are running out of time. There's a climate emergency and the reality is that even where there is progress, it is not moving fast enough. To meet the Paris Agreement's target of limiting global warming to 1.5°C, emissions need to be reduced by 43% before 2030, and peak by 2025.[vii]

Shareholder primacy is often held up as a barrier to stakeholder capitalism and is used by some companies as justification for decisions that negatively impact on stakeholders, such as employees or the environment. However, developments such as ClientEarth's plans to bring proceedings against Shell's directors for failure to implement a strategy that 'truly aligns' with the 2015 Paris climate agreement, show that boards have an important balance to maintain in ensuring that the decisions that they take are not contrary to either investor expectations or their wider stakeholders.

Increasing ESG regulation and a developing focus on stakeholder capitalism mean that a lack of understanding of directors' duties and the role of stakeholder accountability could lead to reputational damage and liability for boards.

THE MARKET - THE RACE IS ON

Evidence also suggests that corporate purpose is good for business. A 2020 study found that brands that are perceived to be purposeful outperform brands who are not. Over a 12-year period, brands with high perceived positive impact had a brand value growth of 175%, versus 70% for low positive impact brands.[viii]

At the culmination of its 10-year Sustainable Living Plan, Unilever found that its Sustainable Living Brands (e.g., Dove and Hellmann's) consistently outperformed the average growth rate of the rest of the portfolio. There were savings as well, for example, it calculated that an improvement in water and energy efficiency in its factories and a reduction of waste avoided over €1bn in costs.

The pandemic has amplified the corporate mindset that purpose is not just an add-on but something that cuts across every area of the business and there are some sophisticated players out in front. The purpose market has grown in response with a proliferation of professional services and consultancies responding to client demand on the ESG agenda.

However, not everyone is on board. It is important to acknowledge that there is some resistance to corporate purpose and the role of stakeholder accountability in the market. Whether you believe that mayonnaise should have a purpose or not, there is still a school of thought that shareholder primacy is integral to corporate success and that stakeholder capitalism is a fad.[ix]

$10 trillion

of business opportunities can be unlocked by transitioning to a nature-positive economy[x]

A clear and consistent language is a foundation for transparency and accountability. Many corporates have adopted the UN Sustainable Development Goals (SDGs) as a framework for their purpose and responsible business activities. In some areas this has carried across into government policy, for example in UK public procurement, the Social Value Model cross-refers to relevant SDGs in terms of the impact it aims to encourage.[xi]

Consistent reporting frameworks can drive a common language but whilst the range of regulation and reporting obligations around ESG has increased significantly, it has not yet offered this clarity.

STAKEHOLDER ACCOUNTABILITY

The definition of a stakeholder will differ depending on the company. The Chartered Governance Institute UK & Ireland (CGI) and Investment Association defines stakeholders as '*those groups which are likely to be affected by the actions of a company, or whose actions can affect the operation or business model of the company*.' The guidance sets out 10 principles for boards, the first of which is identifying who their stakeholders are.[xii]

For the purposes of this toolkit, we have considered those stakeholders specifically mentioned in section 172 (1) Companies Act 2006 which are employees, suppliers, customers, the community, the environment, and members of the company. Current Company law in the UK provides that a director has a duty to act in a way which they consider will be most likely to promote the success of the company for the benefit of its members. In doing so they must consider, among other matters, 6 factors including the interest of employees and the impact on the community and the environment.

Some, such as the Better Business Act (BBA) campaign, argue that the current law does not always enable or encourage directors to further and protect the interests of other stakeholders while seeking to deliver profits for shareholders.

A HEALTHY PLANET IS FUNDAMENTAL TO SECURE A LIVEABLE FUTURE FOR PEOPLE ON EARTH AND THAT IS WHY WE SAY THAT THE NEEDS OF CLIMATE, NATURE AND LOCAL COMMUNITIES HAVE TO BE CONSIDERED TOGETHER AND PRIORITIZED IN DECISION MAKING AND PLANNING - EVERY DAY AND IN EVERY REGION OF OUR WORLD.

UN Intergovernmental Panel on Climate Change

Whilst stakeholder accountability is not enshrined in the Companies Act 2006, it does appear in regulation, guidance and in more specific instances, other UK legislation. For example, the Modern Slavery Act which requires large corporates in the UK to report against their work to ensure that slavery and human trafficking are not taking place in their businesses and supply chains.

This is also apparent in the Public Services (Social Value) Act 2012 and the subsequent Social Value Model which means that social value is given a 10% weighting in bids for central government contracts and includes criteria such as bidders having an *'Understanding of how to influence staff, suppliers, customers, communities and/or any other appropriate stakeholders through the delivery of the contract to support environmental protection and improvement'* or including '*measures to involve local stakeholders and/or users in design (e.g. in the design of services, systems, products or buildings)*.'

These provisions reflect an expectation that organisations consider and engage with stakeholders beyond shareholders, but the mechanisms for those stakeholders to hold those organisations to account are less clear.

HOW TO ACHIEVE STAKEHOLDER ACCOUNTABILITY

There are various means for achieving and demonstrating multi-stakeholder accountability such as:

- private certification, e.g., as a B Corporation
- corporate structure
- common law
- legislation.

Private certification

Companies looking to adopt a framework of stakeholder governance may consider independent certification. Achieving certification offers an internationally recognised authentication of an ethical approach to business.

B Corporation (or B Corp) is a private certification of for-profit companies of their 'social and environmental performance.' It is distinct from the legal designation as a benefit corporation. B Corp certification is conferred by B Lab, a global non-profit organisation. To be granted and to maintain certification, companies must receive a minimum score of 80 from an assessment of 'social and environmental performance', integrate B Corp commitments to stakeholders into company governing documents, and pay an annual fee based on their annual sales. Companies must re-certify every three years to retain B Corporation status.

Another well know certification is Fairtrade, a global movement to improve the lives of farmers and workers in developing countries by ensuring that they have access to export markets and are paid a fair price for their products. Those objectives are often achieved by establishing direct trading relationships between small-scale producers in Africa, Asia, and Latin America and fair-trade organizations (FTOs) in the United States and Europe, thereby eliminating intermediary buyers and sellers. A subsidiary goal of the movement in developed countries is to increase consumer awareness of unjust and unfair international trade practices. The certification process is complex and rigorous, generally taking anywhere between 6-9 months for a producer to achieve Fair Trade Certified status.

Corporate structure

Businesses can entrench their accountability to a range of stakeholders through their corporate structure and constitution, including by use of golden shares, amendments to the company's governing documents, and through employee ownership of the corporate, such as a Limited Liability Partnerships (LLP).

Governing documents

One of the simplest and most effective means for a business to signal its purpose and intended stakeholder accountability is by including these provisions in its constitutional documents. For example, in its Articles of Association, which set out its management, creating a contract between the company and its members.

For example, companies wishing to apply for B Corp certification in the UK must amend their governing documents to state that the objects of the company are to promote the success of the company for the benefit of its members as a whole and through its business and operations, in order to have a material positive impact on (a) society and (b) the environment, taken as a whole.[xiii]

Further, the governing document must include the provision that '*for the purposes of a director's duty to act in the way he or she considers, in good faith, most likely to promote the success of the company, a director shall not be required to regard the benefit of any particular stakeholder interest or group of stakeholder interests as more important than any other.*'

Constitutionally embedding a social or environmental purpose and additional directors' duties to pursue that purpose is an approach taken by many social enterprises in the UK and forms the basis of Social Enterprise UK's eligibility criteria for member organisations.[xiv]

However, Articles of Association can be easily changed with the agreement of shareholders representing 75% of the voting rights in the company. For this reason, a purely constitutional approach to stakeholder accountability may be vulnerable to change and dilution in the long term.

Asset-locked entities

Asset-locked entities such as a charity or Community Interest Company (CIC) in the UK are corporate forms designed for public benefit activity. A CIC is adopted by social ventures that want to use their profits and assets for the community it is formed to serve; a CIC must pass the 'community interest test' being that a reasonable person would consider that its activities are being carried on for the benefit of the community. Charities and CICs are subject to specialist regulators which ensure that they fulfil their charitable or community purpose and remain accountable to their relevant beneficiary groups.

Golden shares

A golden share is a single special rights redeemable preference share in a company where its holder's consent is required for, among other things, material disposals, share issues or a voluntary winding up. Historically, this golden share was held by a government minister as a means of protecting national interest in utilities, defence and industrial companies which were being privatised. More recently, social enterprises have innovated and have issued golden shares to a trusted third party that has responsibility over the social mission, so any change to this requires that third party's approval.

In this new context, the purpose of a golden share is to guard against mission drift or new investors wanting to change the social mission over time. Doing so makes a clear transparent public statement that social mission is central, allowing the enterprise to differentiate itself. A golden share has been used to represent one or more stakeholder or beneficiary groups. A potential drawback to the golden share is that it requires identifying an appropriate representative who has the relevant expertise and skills and can safeguard the enterprise's purpose in the long term. Additionally, potential investors may have concerns that they do not have the ultimate control over the enterprise. However, investors should have confidence that their money will be used for the social purpose they intended, and that the enterprise is committed to that social purpose in the long term.

Employee ownership

Where a business wishes to fully embed accountability to its employee stakeholders it may adopt a model of employee ownership, meaning that all employees have a 'significant and meaningful' stake in a business. This means employees must have both a financial stake in the business (e.g., by owning shares) and a say in how it's run, known as 'employee engagement'. In a private company limited by shares, employees hold shares in the business through share schemes like Share Incentive Plans (SIP). Other corporate structures such as a LLP also allow for employee ownership of a business and a say in operational decisions, for example, the partnership of a law firm set up as a LLP. Different ways of engaging employees are suitable for different businesses, but can include:

- an employees' council, or other consultation group
- a constitution defining the company's values and its relationship with employees
- employee directors on the board, with the same responsibilities as other directors
- working with trade unions on issues like pay and conditions.

WE HAVE SEEN THE LIMITATIONS OF TRADITIONAL STAKEHOLDER CAPITALISM WITH THE PERSISTENT PROBLEM OF SHORT-TERM PLANNING. WE HAVE SEEN THAT STATE PLANNING DOES NOT PROVIDE A VIABLE ALTERNATIVE EITHER. SO, WE ARE LOOKING FOR SOMETHING THAT PROVIDES THE BEST OF BOTH AND EMPLOYEE OWNERSHIP IS ONE WAY OF DOING THAT[xv]

Vince Cable, Ex-Business Secretary

Common law

There has been recent pressure on the fossil fuel industry through the courts. In a case brought by Friends of the Earth, the district court in the Hague ordered Europe's largest oil company, Royal Dutch Shell, to reduce its carbon emissions by net 45% by 2030 compared with 2019 levels.

This is the first case in which a court has confirmed a duty of care for corporations in guarding against the harm and the risks of harm caused by climate change. The court derived this obligation from an unwritten duty of care in the Dutch civil code. It gave substance to this duty from sources ranging from articles in the European Convention on Human Rights, to international climate accords and scientific reports, and guidelines for business protection of human rights agreed by the United Nations and the Organisation for Economic Co-Operation and Development (OECD).

The most noteworthy part of the Royal Dutch Shell ruling is that it is an unprecedented expansion of the duty of care set out in the decision by the Supreme Court of the Netherlands in 2019 in the Urgenta case, which required the Dutch government to mitigate the impacts of climate change and cut emissions, to private corporations. Additionally requiring that corporations must actively prevent, mitigate, and remedy any violations of human rights.

Given that Royal Dutch Shell is often cited as one of the foremost companies to confront climate change in the fossil fuel industry, this ruling is likely to impact the behaviour of other fossil fuel companies that have vague emissions reduction plans – or no plans at all.

Contractually

Businesses can also embed purpose into their commercial endeavours through contractual commitments. The Chancery Lane Project (TCLP) has been set up to facilitate contractual solutions to climate change. TCLP is a collaboration among lawyers from around the world to develop new contracts and model laws to create and embed in market practice the use of legal frameworks to have a positive impact on the environment.

Legislation

A legislative approach to increasing corporate stakeholder governance is not without precedent and legislation. The US public benefit corporation or the Enterprise or Société à Mission in France enables companies to pursue a social or environmental mission in tandem with commercial success and sustainability.

In the UK, the BBA campaign aims 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 1,200 businesses, all who have signed up to the coalition in support of the proposed changes to the Companies Act.

WHAT ARE BUSINESSES DOING?

Below are several case studies of mechanisms that are being used to embed stakeholder accountability.

Employees

Employee pledges - Federated Hermes International (Hermes) is a UK based investment manager, and a subsidiary of US based Federated Hermes. Hermes' corporate purpose is to create sustainable wealth for its investors and the community. From this corporate purpose, Hermes has derived an employee pledge, which includes a commitment that Hermes employees will act ethically, to the benefit of their clients, advocate for the environment and the community within the industry and treat colleagues with respect. An employees' bonus is awarded based on that employee's adherence to this pledge.

Employee ownership – Arup is a British professional services firm which provides services across every aspect of the built environment. Arup is owned by Trusts for the benefit of its employees. Arup say that Trust ownership allows them to take a long-term view without external pressures from shareholders or the risk of a change in ownership. Its governance report states that it encourages a robust freedom of expression within the firm and that its Trust ownership helps to bypass traditional hierarchies that might otherwise suppress the reporting and addressing of issues.[xvi]

Suppliers

Science-based targets – One BITC member, a UK-based multinational insurance company, has a target to reach net-zero carbon by 2040. A key part of this plan is addressing supply chain emissions by ensuring that purchased goods and services are aligned to the low carbon economy transition. The company is taking a two-phase approach: in the short term by setting supplier engagement targets to drive the adoption of science-based targets amongst suppliers, and in the long term by measuring the emissions produced by suppliers and setting reduction targets on these.

Board representation - Cafédirect plc, is a UK based certified B-Corp which produces fair trade coffee and cocoa. They invest 50% of their profits into Producers Direct, a UK charity operated by Cafédirect's suppliers, mostly smallholder farmers. Cafédirect's suppliers also have direct involvement in the company, with smallholder farmers being represented by two board directors on the Cafédirect board and smallholder farmers owning shares in Cafédirect itself. This close engagement with suppliers helps Cafédirect grow its own business and that of its suppliers in a sustainable way, and allows it to continue to purchase high quality, fair trade and organic coffee whilst being a force for good in the market.

Digital – Unilever is a purpose-driven British multinational consumer goods company. Its purpose is to make sustainable living commonplace. Unilever operates on the basis that brands with purpose require a supply chain with purpose. Its Partner with Purpose programme works to build closer relationships with its suppliers by encouraging more responsible and transparent innovation to deliver on Unilever's commitments and generate mutual growth together.

In terms of traceability and transparency, a key factor for successful stakeholder accountability, Unilever uses digital to drive sustainability. For example, it recently announced a pilot of the GreenToken by SAP solution to further increase transparency in its global palm oil supply chain. It says, *'Unilever is committed to achieving a deforestation-free supply chain by 2023, and blockchain technology has the potential to help companies, like ours, track their supply chains to ensure the commodities we source respect people and the planet'.*[xvii]

Contractual – Vodafone Group Plc is a British multinational telecommunications company. Vodafone has embedded climate-related provisions in its procurement contracts by working with clauses produced during the Chancery Lane Project. Vodafone consulted with internal and external stakeholders to create two clause templates for suppliers: a low-risk template appropriate for SMEs and lower-emitting suppliers and a high-risk template with more detailed and onerous obligations tailored to suppliers with larger carbon footprints, such as reporting and termination provisions and options for alternative drafting.[xviii]

Community

Corporate structure – Riversimple is a UK based social enterprise which designs and builds hydrogen powered cars. Riversimple has adopted a corporate structure which ensures all its stakeholders have a real say in how the company is run, with each stakeholder being represented by a 'Custodian' company that holds voting shares in the company. The six Custodians represent – the environment, Riversimple's customers, Riversimple's staff, its investors, its commercial partners, and the community in which it operates. Riversimple believe that these six stakeholder groups are all critical to the success of the business, and that there is no inherent conflict between these interests- if the business is designed in this way it will garner a greater level of goodwill than is possible in a single stakeholder entity, delivering a more profitable and more resilient business.

Social bond – Pearson Plc is an educational publisher. In 2020, the education company issued a social bond linked to education with proceeds used globally for virtual learning and teaching for underserved learners and communities, including those from low-income backgrounds, with disabilities and the unemployed. Pearson intends to hold itself to account publicly for the learning outcomes funded by the bond's proceeds and independently audit the impact on educational outcomes.[xix]

Asset-locked entity – The Wyre Catchment Community Interest Company was set up as part of a project to develop innovative funding opportunities for implementing Natural Flood Management measures on the River Wyre and its tributaries to help at-risk communities in Lancashire. The project was developed by several stakeholders including the Rivers Trust, Wyre Rivers Trust, Environment Agency, United Utilities, Triodos Bank, Co-op Insurance and FloodRE with funding from the Esme Fairbairn Foundation. In order to cooperate and fundraise, the parties opted to incorporate a Community Interest Company for the benefit of the communities in the catchment of the River Wyre in order to reduce flood risk. The Articles of Association provide for an asset lock meaning that profits are ring-fenced for the benefit of the community and relevant stakeholder groups have the right to nominate a representative director.

Environment

Golden Share – Toast Ale is a social enterprise which uses surplus bread to brew beer, replacing barley and using less land water, and energy, thereby avoiding carbon emissions. Toast Ale commits 100% of its distributable profits to food waste charities to fund systemic change to fix the food system. To remain accountable to its mission, Toast Ale has issued a golden share which provides the golden shareholder with veto rights over any proposed changes to the company's Impact Mission.

Partnerships – Anglian Water has embedded a legal requirement for its board of directors to take account of the impact of the company's decisions on the environment in its Articles of Association. One of the ways in which it does this is through partnerships, for example, with Low Carbon Farming and the development of greenhouses that grow tomatoes in a hydroponic system using waste heat from Anglian Water treatment facilities. The developments aim to create jobs, reduce food miles by increasing local food production and cut carbon emissions.

Finance – Financial instruments such as sustainability linked loans enable lenders to incentivise the sustainability performance of borrowers over the term of the loan. They aim to align loan terms to the borrower's performance, which is measured against specified sustainability KPIs.

4 TIPS FOR BUSINESSES

Identify your stakeholders

BITC defines a stakeholder as anyone with influence on, with interest in, or who is impacted by, a company's business, projects, or products and services. We recommend keeping an up-to-date list of all your internal and external stakeholders, ensuring this includes a diverse range of perspectives across environment, communities, and value chain.

Then, for any one project, strategy, or issue, you must think about:

- which of these stakeholders are creating the drivers and pressures,
- which stakeholders might be affected by it
- which stakeholders are you being held accountable to
- which stakeholders will be implementing it.

Once you have identified your stakeholders, we recommend creating a stakeholder map to assess how to engage with them. A classic stakeholder map places stakeholders in order of interest versus influence to allow companies to focus on those that would have the most impact on a particular strategy, project, or issue.

Stakeholder engagement isn't stakeholder accountability unless you listen and respond

Companies can engage with stakeholders in many different ways, including the examples of stakeholder governance highlighted above, but also in less formal ways, such as focus groups or engagement surveys. However, this risks being perceived as a 'tick box exercise' unless something actually comes of it. Effective stakeholder accountability means collaborating with your stakeholders and showing how you have responded and taken into account their views, whilst empowering them in your decision-making through joint ownership and shared responsibility. Think about employee ownership, board representation and customer advisory boards.

Measure and communicate the links between stakeholder capitalism and commercial success

As laid out earlier in the toolkit, there is still a school of thought that stakeholder accountability is a fad that will pass with time, and that prioritising shareholders is what will result in commercial success. However, stakeholder accountability is not about compromising the success of the company, it is about taking a broader, longer-term view in order to achieve company success.

A meta-analysis of hundreds of corporate responsibility studies by IO Sustainability and Babson Social Innovation Lab found that firms that treat their stakeholders well have the potential to increase their market valuation by 40% to 80% compared to companies with average or weak relationships. In turn, when a firm performs well financially, good stakeholder relations help sustain this positive performance for a longer period of time.[xx]

When stakeholder interests are aligned, companies are in a strong position to ensure business sustainability for the long-term. Golden shares, social bonds and other financial instruments can be effective methods to ensure that financial performance is linked to social and environmental KPIs, ensuring a longer-term view and, therefore, long-term profitability.

Become a leader in stakeholder governance before it become compulsory

For many sectors, regulation already provides a requirement for businesses to be accountable to their stakeholders. However, a legislative approach for all companies is not without precedent and we may see this change happen in the near future. Organisations such as ShareAction and the BBA are already campaigning for change in the UK.

If you do not want to be left behind, it is imperative to start thinking about stakeholder governance and how it applies to your business early on. Otherwise, there is a risk that a legislative change will come and your business will not be prepared for it. To learn more about legislation, stakeholder governance, and the BBA, you can read our joint research report: '[Is legislation the best way to achieve Stakeholder Capitalism?]', where we interviewed 15 companies to explore how they think legislation may affect the future of business.

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ENDNOTES

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