

Future of the Corporation |

Towards an inclusive economy. Why company purpose holds the key

Output of a Breakfast Briefing held on 1st December 2016

BY LUKE FLETCHER AND JAMES PERRY

INTRODUCTION FROM COLIN MAYER

This business breakfast was the first in a series held as part of the British Academy's new programme on The Future of the Corporation, a major research and engagement programme designed to inform the development of a new model for purposeful companies in the 21st Century. Central to this discussion is that of the legal framework guiding and enabling companies in developing 'better', or more responsible and broad purposes. This session, held at the British Academy and introduced by James Perry, Co-Founder and Director of COOK food and Luke Fletcher, a partner at the law firm Bates Wells Braithwaite, explored the effectiveness of the primary legislation, specifically the role of Section 172, which was designed to allow businesses to redefine their purposes to extend beyond purely maximising shareholder value.

INTRODUCTION

The year 2016 was the year the world changed. Suddenly, there seem to be few political certainties. A deep-seated unease and anxiety about how globalisation is working and about levels of inequality has led to a sweeping away of the established political order. After a generation of integration, the United Kingdom is leaving the European Union. On both sides of the Atlantic, the system of capitalism we operate and basic rules of international trade and commerce are at risk of losing public support.

At the heart of the capitalist system is the doctrine of 'shareholder value', which shapes the purpose of the company – the primary vehicle through which private enterprise is harnessed and directed. This doctrine teaches us that those charged with responsibility for running companies should do so principally to further the interests of the shareholders who have trusted their capital to the company.

Against this backdrop, an alternative conception of the company is gaining ground. This alternative vision argues that not only does business have a responsibility to society but that shareholder value depends in the long run on the creation of value for all stakeholders with an interest in business. It recommends that boards be charged with creating shared value for all stakeholders, on the basis that this is the safest and most sustainable foundation for capitalism in a changing and uncertain world.

Now is the time to give this alternative conception of the company, which sees business as a force for good in society, a chance to compete on a level playing field with the traditional notion of the company as a vehicle for private gain – by creating a new *optional* company model with *equal legal status*.

PROFIT WITH PURPOSE – AN INCLUSIVE APPROACH

The Government Inclusive Economy Unit has undertaken an investigation of the current and potential role of those businesses which operate for a wider purpose, as well as for profit. On 6 December 2016, the Advisory Panel to this ‘**Mission Led Business Review**’ submitted its report to Government, along with a series of recommendations to grow the depth, breadth and strength of businesses operating this kind of ‘profit with purpose’ model.

One of the key recommendations was that the Government should explore the introduction of a “benefit company” status in English law, along the lines of the “benefit corporation” designation which has rapidly emerged in the United States in recent years and is now available in 32 states.¹

Even without any formal legal status, initial research suggests that there are already approximately 123,000 mission led businesses in the UK, accounting for 4.3% of turnover in the UK private sector.

The Advisory Panel concluded that the introduction of a benefit company would provide a clear signal that the Government wishes to enable and encourage mission-led businesses. The panel felt that, over the long-term, a consistent approach would make it easier for consumers, investors and commissioners to identify those businesses which operate for a wider purpose alongside profit and, if appropriate, reward or encourage them. It was pointed out that, as in the United States and Italy, greater transparency requirements could be attached to a new status, to prevent “*green washing*”.

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SECTION 172(1) – THE DEFAULT COMPANY PURPOSE

Section 172(1) of the Companies Act 2006 enshrined in statute what is often referred to as the principle of “*enlightened shareholder value*”. The duty codified in this section requires a director to act in the way he or she considers, in good faith, would be most likely to promote the success of the company *for the benefit of its members* as a whole and, in doing so, have regard to the factors listed.

In our view, the subordination of the interests of wider society to the interests of shareholders is a weakness at the heart of company design.

Section 172(1) places a clear limit upon the extent to which directors may create social and environmental value, which are contingent upon and subordinate to the creation of shareholder value. The vast majority of companies operate under the ‘default company purpose’ set out in s172(1).

In our view, the subordination of the interests of wider society to the interests of shareholders is a weakness at the heart of company design – one that may prove fatal in the battle for the hearts and minds of the wider public and which in the long term puts companies’ licence to operate at risk.

SECTION 172(2) – A PLATFORM FOR PROFIT WITH PURPOSE

Section 172(2) of the Act permits companies to adopt purposes other than the benefit of members and, where companies adopt such purposes in their Articles, the directors are obliged to promote the success of the company by seeking to achieve the relevant purposes.

Unfortunately, the flexibility provided by s172(2) is little known or understood. No thought is typically given to the articulation of the purpose of the company in the drafting of modern company Articles and the economy as a result lacks a diversity of company purpose, which has led to group think around the primacy of shareholder value in corporate governance, law, regulation, thinking and practice.

However, an increasing number of companies are taking an inclusive approach to the articulation of company purpose by establishing that benefitting society and the environment are legitimate and integral ends that are part of a rounded understanding of the role of business in modern society and should not properly be seen as being in conflict with creating value for shareholders.

B CORPS – A MODEL FOR PROFIT WITH PURPOSE

The ‘B Corp’ movement shows how companies may take a ‘triple bottom line’ approach to business by combining the three purposes of benefitting shareholders, society and the environment.

A B Corp is a ‘for profit’ business which is *certified by the charity B Lab* as meeting rigorous standards of social and environmental performance, accountability and transparency. At the time of writing, there are over 2,000 B Corps in 50 countries and 130 industries which all share one declared unifying goal, which is to seek to redefine the meaning of success in business. The movement is spreading rapidly across the globe and is catalysing a wave of corporate law reform in a wide range of jurisdictions on different continents, leading to the creation of a new model of company purpose.

To become a *certified B Corp*, a company must adopt certain legal requirements established by B Lab. This means adopting a revised company purpose which makes benefitting society and the environment an integral part of the company purpose along with benefitting the members. The legal requirements for B Corps based in the UK make use of the flexibility under s172(2). Directors must have regard to the same list of stakeholder interests set out in s172(1) but, unlike directors of companies with the s172(1) default purpose, are not obliged to prioritise benefit to members.

¹ In this paper, we use the terms ‘benefit company’ and ‘profit with purpose’ interchangeably.

² **In Pursuit of Impact: Mission Led Business**, November 2016, Deloitte. Though without formal legal status, it is very hard to define a mission led business and so some approximation is needed.

The legal requirements for B Corps make it clear that no new rights are given to stakeholders and no new causes of action are created by the adoption of the purpose of benefitting society and the environment. In addition, directors of B Corps are required to report on how they have advanced the company's purposes as part of the strategic report filed by the company. The same approach to company purpose may be adopted by any company, whether a certified B Corp or otherwise.

CREATING AN OPTIONAL PROFIT WITH PURPOSE MODEL

If an optional profit with purpose model is created in statute using the flexibility permitted by s172(2) of the Companies Act 2006, it would give official backing to this way of doing business. This could be achieved, for example, by introducing a new s172A to the Companies Act 2006 or by amending s19 of the Companies Act to allow for the Secretary of State to issue model articles and to grant a separate profit with purpose designation to companies adopting prescribed features of the model articles and complying with prescribed accounting and reporting requirements.

There is evidence of significant and accelerating growth in the use of the profit with purpose model, which would only accelerate further with Government backing and support.

An optional model would be very low risk. It would only apply to companies choosing to adopt the model and so companies would remain free to retain the existing shareholder primacy model. The profit with purpose model has been tried and tested now in a number of jurisdictions and in a sizeable cohort of businesses of different sizes in a wide range of sectors and industries in the UK economy. There is evidence of significant and accelerating growth in the use of the profit with purpose model, which would only accelerate further with Government backing and support.

The model has also attracted a remarkable degree of bipartisan support on the right and left of the political spectrum and a discrete technocratic amendment to the Companies Act 2006 should not be expected to receive significant Parliamentary opposition, as part of a wider corporate governance Bill in due course.

Clearly, if a new benefit company model is created, there will need to be some care in the messaging. There are many great companies operating under the existing law who are leaders when it comes to sustainability, concern for employees and work in the community. And yet even such companies will be obliged in the event of conflict to put shareholders' interests above other stakeholder interests.

At the same time, not all benefit companies will necessarily succeed in their purpose to have a positive impact on society and the environment and so a degree of modesty and humility is appropriate. However, the aim to do so is laudable and is worthy of support and encouragement. The branding and positioning of a new legal model should be appropriately sensitive to these nuances.

In our view, the primary role of a benefit company model would be to act as a catalyst and platform to empower large scale leadership and culture change – removing the need always to show a direct impact on profitability, as benefitting wider society and the environment would be an important end in itself.

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The choice to become a benefit company would bring with it some external recognition and acknowledgement and would lead to additional impact reporting requirements. However, in all other respects, benefit companies would be subject to all of the other provisions of the Companies Acts and would continue to be a company in every sense of the word. If we were really talking about the creation of a whole new legal form, that would be a huge task, when you think that the Companies Act 2006, for example, has over a thousand provisions applying to companies limited by shares.

It has been said that the law is already permissive – as s172(2) allows different forms of company purposes – and so there is no need for legislation to allow companies to become profit with purpose.

This is true at the level of the company. However, if the goal is mass adoption amongst companies across the economy so that the movement of business as a force for good is given an equal opportunity to compete with the dominant shareholder primacy model of capitalism, then this will only be achieved by levelling the playing field and creating an official alternative to the default position.

BUSINESS AS A FORCE FOR GOOD

It is time to open our minds to new ways of thinking about company purpose and to create a new profit with purpose model, which supports companies wanting to create shared value for all. Giving this way of doing business official and legal backing would electrify and harness a movement of people seeking to use business as a force for good. Surely, this is the kind of change we need.

James Perry, Director, COOK Food

Luke Fletcher, Partner, Bates Wells Braithwaite

DISCUSSION POINTS

At the discussion on 1st December the following questions were raised in response to these presentations, including:

- How can companies be encouraged to adopt broader purposes without tighter regulation forcing compliance?
- What is the role of culture change in creating more purposeful companies?
- What is the role of the Board, and how can shareholders be engaged to support implementation of new purposes?
- How does the large diversity of shareholders improve or hinder chances of success in embedding wider purposes?

SPEAKER PROFILES

Luke Fletcher is a Partner at Bates Wells Braithwaite; Luke specialises in charity, social enterprise, responsible business and impact investing. He is Chair of the European Social Enterprise Law Association and led the work to define the legal requirements for B Corps in the UK. He is also a member of the British Academy's Steering Group on *The Future of the Corporation*.

Colin Mayer is a Fellow of the British Academy, the Lead Academic on the British Academy's *Future of the Corporation* programme and a Professor of Management at the Saïd Business School. Colin was chairman of Oxera Ltd. between 1986 and 2010 and was instrumental in building the company into what is now one of the largest independent economics consultancies in Europe. He was appointed CBE in the 2017 New Year Honours for services to business education and the administration of justice in the economic sphere.

James Perry is co-founder and Director of COOK – the social-hearted business he co-owns with his brother which now employs 650 people and is rolling out across the UK. He is also co-founder of B Lab UK, the charity co-ordinating B Corp activity in the UK. He is a member of the British Academy's Corporate Advisory Group for *The Future of the Corporation*.

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NEXT STEPS

The British Academy is holding a series of breakfast events as part of the *Future of the Corporation* programme – Charles Wookey, CEO of a Blueprint for Better Business will explore the practicalities of putting new purposes into practice in March 2017, and a further paper will follow. The Academy will use the discussions at this and other briefings to help shape the call for applications for original research in Spring 2017 and will use this and other research to inform discussions with policymakers on these topics. The Academy invites potential partners to contact **fotc@britac.ac.uk** to hear more about the *Future of the Corporation* programme.