

Proposed Revisions to the UK Corporate Governance Code

Submitted by UnLtd: the Foundation for Social Entrepreneurs to the Financial Reporting Council in response to its consultation published December 2017

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UnLtd is the Foundation for Social Entrepreneurs.¹ Our vision is a future where enterprising people are transforming our world for good. We find social entrepreneurs with bold solutions to today's challenges. Through funding and support, we help them to realise their potential and create lasting change.

We welcome the FRC's initiative to revise the UK Corporate Governance Code, and the opportunity to respond to this consultation. Although UnLtd's focus is on social entrepreneurs and the early stages of their ventures' development, we recognise the importance of alignment across the business ecosystem on issues of purpose and governance.

In recent years, we have observed increasing interest in purpose-led business models, both among new founders and established companies. New approaches to embedding purpose within the governance of companies are being introduced and tested. Purpose can help founders to build companies that reflect their ethics and values. For some entrepreneurs, this means putting a social or environmental purpose at the heart of the business. For others, it means delivering social impact alongside commercial goals. Some of these companies are disrupting existing industries and may well

¹ Registered charity 1090393.

become the market leaders and listed companies of the future. At the same time, companies of all shapes and sizes are being expected to make a substantial contribution to society.

It is important that the revised Corporate Governance code reflects this range of types of company, and allows full use of the existing flexibility within company law when it comes to purpose. In our view, the proposed revisions to the Code and associated Guidance fail to do so, and we wish to make specific suggestions for amendments that would rectify this.

Our comments relate primarily to Principle A and paragraphs 9, 10, 41 and 42 of Appendix B, included here for reference:

Principles

- A. A successful company is led by an effective and entrepreneurial board, whose function is to promote the long-term sustainable success of the company, generate value for shareholders and contribute to wider society. The board should establish the company's purpose, strategy and values, and satisfy itself that these and its culture are aligned.**

AN EFFECTIVE BOARD

9. An effective board develops and promotes its collective vision of the company's purpose, along with the values and the behaviours it wishes to promote in conducting its business and sets a strategy consistent with these. It will be able to explain how events or developments affecting the long-term success of the company have been addressed.
10. At the heart of a director's duties (see Figure One) lies a focus on generating and preserving value for shareholders for the long-term, taking account of the interests of the company's workforce and the impact on other stakeholders such as customers, suppliers, the community and the environment.

Setting the Framework

41. Boards should start by determining the company's purpose and clearly defining a set of values that are aligned to that purpose and the company's strategy. Simply adopting a formal values statement is not enough. In order to have an impact on behavioural outcomes and influence the way business is done, values need to be embedded at every level of the organisation.
42. Boards should seek assurance that management has put appropriate mechanisms in place to implement and embed the company purpose, strategy and values. In particular, incentives and rewards, promotion and development decisions should be aligned to these. Boards should satisfy themselves that this is clear in company policies and is applied in practice, challenging themselves and management on how effective they are at shaping and embedding culture, for example in the areas suggested below.

Our response to the consultation

1. We strongly welcome the recognition in Principle A that the board should, among other things, ensure that the company contributes to wider society. This should apply to all companies, irrespective of their purpose.
2. We also welcome the clear emphasis on establishing the company's purpose in Principle A and elsewhere in the Code and Guidance.
3. We note that while Principle A is consistent with S172(1) of the Companies Act, its final wording must also be consistent with S172(2), which states:

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
4. In our view, both Principle A and paragraph 10 of Appendix B are inconsistent with S172(2), because they assume that all companies hold the benefit of members as their primary purpose, in line with the default as specified in S172(1).
5. This is not just a matter of principle. We know from our own work as well as that of the government's Mission-Led Business Review and other sources that there is an increasing number of companies that wish to take advantage of S172(2). Some of these companies adopt a specific purpose other than the benefit of members as their primary purpose. Others specify a purpose alongside the benefit of members. Some companies wish to adjust the relative priority given to shareholders versus other stakeholders, so that the interests of other stakeholders are treated on a par with or ahead of those of shareholders.
6. Promoting greater awareness and application of S172(2) is an expressed policy priority of the government. UnLtd has worked closely with DCMS, BEIS and Companies House officials on a digital tool, Purposely (getpurpose.ly), which helps company founders to understand and act on the flexibility allowed within S172(2) by embedding their purpose within their articles of association. Purposely was launched in beta version earlier this month.
7. We are therefore concerned that Principle A and paragraph 10 of Appendix B do not adequately allow for companies to which S172(2) applies. We recommend that both are amended accordingly. A Provision should be added to the Code that explicitly recognises that companies may wish to specify a purpose or purposes instead of or alongside the benefit of members, and that the prioritisation of interests as expressed in S172(1) may be amended accordingly.
8. We also wish to comment on paragraphs 9, 41 and 42 of Appendix B. For all the current enthusiasm about purposeful business, there is a real risk of 'purpose-wash' as a result of

companies making superficial commitments to purpose, without sufficient embeddedness. We therefore strongly support the statement that purpose and values should be embedded at every level of the organisation and represented in policies and practice. We agree with the approach described in these paragraphs and do not disagree with any of this content.

9. However, we believe that this approach may prove insufficient, and that the Code and Guidance should encourage companies to underpin this approach by embedding their purpose and values directly in their articles of association and hence within the duties of directors. Otherwise, the company risks creating a misalignment of duties in the minds of directors, which some may feel obliged to resolve by prioritising the articles over any subsidiary policies.
10. Our concern is that, in practice, this is likely to result in some cases in the interests of shareholders being given priority where there is any doubt about possible competition between competing interests. This risks undermining the purpose and values of the company.
11. In our view, companies could mitigate this risk by unambiguously incorporating their purpose and values directly in their articles of association. This would empower directors to act fully in line with the company's purpose and values.
12. This would also have the added benefit of increasing transparency and credibility vis a vis its stakeholders. Recent public polling by Message House for UnLtd found that 40% of survey respondents agreed that "purpose is used by businesses for marketing and corporate spin." 61% agreed that "claims about purpose are often not backed up with any substance." When asked what measures would convince respondents that a business is taking its purpose seriously, the second highest response (at 54%) was "adding their purpose in their company's governing documents to make it legally binding."
13. We would be pleased to provide further information as required as you work towards finalising the Code.