

Department for Business, Energy and Industrial Strategy

Green Paper on Corporate Governance Reform

Response from

The Durham Company Law Project

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The Durham Company Law Project Steering Group

The Durham Company Law Project is a project of Durham University Business School (www.dur.ac.uk/business) and the Centre for Catholic Social Thought and Practice (www.ccstp.org.uk). Its purpose and the reason for this response is to draw on Catholic Social Thought to inform the reform of company law.

Nick Deeming has over 25 years' experience as a lawyer and businessman, the majority of it at the heart of global and listed organisations, including Transocean, Christie's and BOC. He currently holds a number of non executive director positions, he is a senior executive coach and he is a senior advisor to *A Blueprint for Better Business*.

Maurice Glasman is an English academic, social thinker and Labour life peer in the House of Lords. He is Director of the Common Good Foundation.

Mark Hayes recently retired as St Hilda Reader in Catholic Social Thought and Practice and remains an Honorary Fellow in the Department of Theology and Religion at Durham University, and a senior member of Robinson College, Cambridge. He is an economist with a background in finance, as an investment manager at 3i, and as principal founder and Managing Director of Shared Interest, a financial co-operative supporting the Fair Trade movement. He has acted as the primary draftsman of this submission.

Clifford Longley is an author, broadcaster and journalist who has specialised since 1972 in the coverage and analysis of British and international religious affairs. He currently has a column in *The Tablet*, of which he is also Editorial Consultant. He has written extensively on Catholic Social Thought and is a Trustee of the Centre for Catholic Social Thought and Practice.

Geoff Moore is Professor of Business Ethics at Durham University Business School. His areas of work include corporate social responsibility, stakeholder theory, corporate moral agency and Fair Trade. His particular area of interest is around the application of moral philosopher Alasdair MacIntyre's virtue ethics approach to organisations.

The members of the Steering Group make this response in their personal capacities and the views expressed do not necessarily reflect those of any organisation with which they are associated.

Response to the Green Paper on Corporate Governance Reform

This response begins by addressing some issues of principle before turning to the specific questions raised for consultation. The following preamble may be taken as an answer to Question 14.

The premise of the Green Paper is that the purpose of most companies is to pursue enlightened shareholder value ('ESV'). Its principal motivation is the perceived problems with executive pay together with some egregious examples of unscrupulous behaviour but its wider purpose is 'to enhance public trust in business as a force for good' (p.12). The various options for reform are framed within the concept of ESV and therefore do not easily admit criticism of the premise itself.

The Green Paper's approach to stakeholders, as defined by s.172 of the Companies Act 2006, is instrumental (para 2.4); one might represent this as the case for greater enlightenment in the pursuit of shareholder value. The interests of stakeholders are perceived as an external constraint rather than an internal goal of the company. The phrase 'strengthening the stakeholder voice at board level' (p.34) needs interpretation, since - on the premise of ESV - stakeholders, as such, have no right to speak in the boardroom. The proposed options for reform aim to ensure that the directors hear the voice of the stakeholder clearly in an informed dialogue, yet the stakeholder remains an external third party, who may be treated cordially and respectfully, sometimes even invited into the room, but only if this closer dialogue is seen as a means of enhancing shareholder value. At root, the stakeholders are not members of the company but counter-parties with whom the company transacts.

We suggest that within the framework of the existing s.172 it is possible to promote a different model of the company, capable of bringing about substantive change that would warrant greater public trust in business as a force for good, and create stronger businesses that focus on long-term value creation. This model returns to the idea of the company as a human association of investors and workers, a community of enterprise whose purpose is to earn income through serving the common good, where this includes the interests of customers, suppliers, the natural environment and the wider community. There is evidence that this would lead in the long run to substantial improvements in performance, productivity and competitiveness. The detailed case for this model is set out in our working paper *Redefining Corporate Purpose: The Need To Recognise Membership Through Work*, available at www.ccstp.org.uk/company-law/.

We have submitted to the Commons Select Committee (CGV0029) that the following legal reforms are necessary if companies are to move beyond ESV:

- **The success of the company should be understood as the success of the business enterprise which it conducts.**

- **Qualifying employees should be recognised by statute as members of the company and any group that employs them.** Deemed employee membership would empower directors to pursue the success of the enterprise in which long-term shareholders and workers have a common interest. Without it, s.172 is a dead letter.
- Such recognition would not be sufficient without some transfer of sovereignty over takeover decisions from shareholders to directors and workers. **Directors need to be free to pursue the success of the enterprise without the threat of hostile takeover.** Furthermore, since an enterprise may be worth more to shareholders dead than alive, **the consent of workers as well as of long-term shareholders should be required for takeovers recommended by the directors.**

It is hard to see how the Prime Minister's vision of a fairer economy that works for everyone can be achieved without a change in the model along these lines, to one in which companies combine a wholehearted commitment to successful competitive enterprise with the pursuit of the benefit of their working people as an internal goal, while respecting the legitimate rights and interests of property and rejecting the inevitability of class struggle.

Working from this alternative premise, we turn to the other questions raised in the Green Paper.

Executive Pay (Questions 1-6)

We regard this as a problem of the ESV model. Unless it can be demonstrated that there is a systemic unregulated conflict of interest between directors and shareholders; or a breakdown in the ability of institutional shareholders to hold directors to account; or sheer incompetence in the structuring of remuneration packages (all of which we doubt are the norm), we regard the high levels of executive pay as mainly a symptom of the pursuit of shareholder value. We suggest that these socially unacceptable levels of pay would be reduced by a change in the model of the purpose of the company.

Strengthening the employee, customer and wider stakeholder voice (questions 7-9)

Answer to Question 7

The reforms we have suggested above under Question 14 would align the purpose of the company with the success of the business enterprise in which both long-term shareholders and employees have a common interest. Both classes of member can prosper without doing so at the expense of the other. It would become the duty of the board as a whole to promote the benefit of both together as part of the common good.

Within such a framework, employee directors (option iii) would no longer be outsiders, potentially undermining the unity of the board. Indeed it is likely that, judged against the

criterion of the success of the enterprise, better decisions would be made, grounded in the tacit knowledge that only those directly engaged in the productive process can possess. Conversely, without a change in corporate purpose, the appointment of employee directors to a unitary board raises the significant difficulties pointed out in the Green Paper, which would apply also to other stakeholder representatives in any case. Please note that we distinguish between workers and other stakeholders; we do not find in stakeholder theory a compelling case for a pluralist model, where the board is supposed to treat all or some other stakeholders besides employees as 'members'.

It is worth noting that in the European two-tier system, there is a division between the exercise of various control rights reserved to the supervisory board (such as the appointment of executive directors, major acquisitions and disposals, share issues and borrowing) and the management board. It is easier to accommodate employee directors on a supervisory board, which is not directly responsible for management.

The Green Paper rules out both mandatory direct appointment of employees or other interested parties to the board, and any move away from the unitary board. Our proposed legal changes are compatible with these constraints.

The other proposed options (i, ii and iv) represent ideas for improving the quality of dialogue between the board as a whole and the non-member stakeholders. See answer to Question 9 below.

Answer to Question 8

Deemed employee membership should apply to all companies as this creates the duty of directors to promote the success of the enterprise for the benefit of employees as well as investors. In itself such membership need confer no rights other than, we suggest, to attend a general meeting with the board of directors. However it would also automatically provide the platform for a derivative claim under s.260 of the Companies Act 2006, giving s.172 some teeth. The combination of access to information with the potential for legal challenge could bring about a significant change in attitudes.

Consent to takeover, reporting requirements, nomination or appointment of directors, etc., for small private, often owner-managed, companies should be left to develop on a voluntary basis in line with a change in culture and practice. The main difficulty arises where there is a separation between ownership and management. Large and medium-sized companies (including their subsidiaries) should be expected to follow some degree of prescription (see answer to Question 9).

Answer to Question 9

We have specified above in outline the type of legal changes we consider necessary (there would in addition be many drafting issues such as the careful definition of a qualifying

employee to include outsourced workers who work mainly or exclusively for the customer company). The partial transfer of sovereignty over takeovers from shareholders to directors and employees would need statutory backing and should apply to large and medium-sized companies and groups, including all listed companies. Without this, a change in corporate purpose could not be sustained against the interests of shareholders. S.168 of the Companies Act 2006, inter alia, would need consequential amendment.

Beyond that and the right to a general meeting, the rights of employee members (as such, as distinct from employment rights) should be specified in a Code for large and medium-sized companies and groups, and be voluntary for small companies. The main criterion of size here is the number of employees to which the appropriate degree of formality is proportional. Legislation can be used to enable but not enforce a change in culture. The Code should expect the appointment of employee directors on a 'comply or explain' basis against the criterion of the success of the business enterprise. The other proposed measures (stakeholder panels, designated NEDs, and fuller reporting) are, for similar reasons, matters for a Code.

Corporate governance in large privately-held businesses (Questions 10 – 13)

Answer to Questions 10 - 13

As the Green Paper points out, the main distinction between a private and a public company lies in the dispersion of shareholdings. Given our perspective, there is no difference between them from the perspective of employees. In the case of large and medium-sized companies in general, employee members could provide an important source of accountability which is otherwise lacking and would greatly strengthen corporate governance. The BHS debacle could not have happened under this model.