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Corporate Governance Reform

for a
New Era of Responsible Businesses

Pre-Second World War, society – including business – did more than the State to provide a safety net for its inhabitants. The Post War Consensus changed this and the State assumed more responsibility. Business has since been left with a narrow focus on profits, failing to do enough to contribute, outside of the basic employment contract, to the communities in which it operates. It needs to do more.

For the world's governments, societies and economies, no question can be more pressing. Enlightened businesses, investors and consumers know that there is only one solution: a Stakeholder Economy, which returns to the principles of citizenry; the serving of the many, not just the few, and one extending social accountability from the limiting sphere of the state to the wider realm of business – producing stronger communities, higher, longer term returns and sustainable growth.

I propose two policy approaches to help move us towards an era of more responsible business. The first is a new approach for corporate reporting, aimed at existing businesses, serving their investors, customers, employees and the wider community. The second is a new, alternative system for company incorporation aimed at new businesses.

1. Corporate Reporting

Allowing investors to better hold businesses to account on executive pay as the Government proposes is an important step and more should also be done to allow investors access to the information they require on human capital. Companies that invest more in training and development and have better occupational health, will reduce turnover, increase production and generate higher returns for investors. Investors should have easy access to this information so they can invest in businesses that take such issues seriously.[1]

But we need to do more than give investors more power. We need systemic change. Capital markets in Britain and elsewhere are still focused exclusively on delivering solely for shareholders at almost any cost, barring an occasional side interest in what are usually lumped together as 'ESG' factors. Whilst this approach generates returns for investors, it does very little to contribute to the wider community and can even damage it, as we saw during the financial crisis.

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[1] http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0591-Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds.pdf

Instead of ESG being ancillary to the operations of a business, these factors need to be at the core of corporate reporting. A new benchmark is required that helps businesses benefit from social contribution outside of a pure for-profit framework, by properly capturing it in a way that can then be shared with investors. To this end, the External Rate of Return (ERR) should be widely embraced.

This new metric, designed in collaboration with the London School of Economics[2], allows all businesses of all types to properly capture, measure and publicly share their contribution to the economy, jobs, employee skills, IP creation, the sustainability of their supply chains and their impact on the environment. Reporting is organised across five vertical themes: company, suppliers, customers, society and environment.

Investors, consumers, employees and government need to build an alliance that encourages businesses to focus on this holistic measure of how a business impacts upon society as a whole – the results will surprise many who presume we can live without capitalism, as it shows the relentless contribution that business makes to our everyday life across a range of metrics – but is also able to hold business to account – and this goes for customers as much as shareholders.

Through the radical transparency of the platform, a wide range of users will be able to measure and compare the impact of all types of business ventures in an holistic and consistent manner. Furthermore, through the ERR platform, companies, customers and the public at large can engage in on-going dialogue about the ongoing impact of a business's activities.

2. Incorporating a new kind of business

In this reputation driven, increasingly transparent world, some businesses are already realising that a profound and lasting commitment to their community is not only the right thing to do, it will also lead to higher returns and sustainable growth.

At the vanguard of this movement is the Benefit Company, which champions a stakeholder alternative to shareholder primacy through its rigorous benchmarking-led system. Promoted by B Lab[3] – the home of the certified B Corporation movement, a community of businesses who marry these legal purposes with a stakeholder performance requirement – Benefit Company laws have now been passed in 32 US jurisdictions and in Italy, with many other states and countries set to follow.

B Lab UK was recently launched by Mark Florman, James Perry and Charmian Love, to engage the 3.2 million mainstream, traditional, non-asset locked UK companies in the urgent mission of generating positive, long-term social and environmental impact. Now, B Lab UK is recommending that the government pass Benefit Company legislation. This corporate law reform gives companies the option to replace shareholder primacy with a stakeholder purpose – with companies explicitly operated for employees, communities and the environment, as well

[2] LSE - http://www.lse.ac.uk/businessAndConsultancy/LSEConsulting/pdf/Assessing-social-impact-assessment-methods-report.pdf

[3] http://bcorporation.uk/meet-b-lab-uk

as shareholders. Benefit companies give boards the option to reject shareholder primacy, and to be managed for the benefit of all stakeholders.

The forthcoming consultation by the British Government on corporate governance should include legislation to allow the creation of these companies, so that those companies who want to incorporate in this way can do so, as they pursue growth and innovation as well as developing sustainable communities along the way. This could be achieved through a simple amendment to Section 172 of the 2006 Companies Act.

These two measures, ERR to evolve corporate reporting to take on a wide range metrics relevant to a broader range of stakeholders, and B-Corporations, a recasting of company law, so that all stakeholders in the community where the businesses operate are accounted for, not just shareholders, will help restore trust in market capitalism.

These measures are as much about changing behaviour, as they are about better demonstrating the contribution business already makes to our society. As we look to the future of Britain, we must look beyond the smaller, shorter term pressures on governance. If we don't bring business in, very directly, to the building of sustainable economies and communities, government will face an impossible task – they will be unable to manage alone. We have two simple measures to achieve this – allow entrepreneurs to form Benefit Companies and invite all businesses to report their external rate of return.

Mark Florman - For further information, please see www.markflorman.com