Board Briefing

Ethics and Section 172

key questions for informed board decision-making

By Stephanie Bates

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Ethics and Section 172
key questions for informed board decision-making

By Stephanie Bates

Ethics and Section 172: key questions for informed board decision-making

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Author

Stephanie Bates LLB has spent over 30 years advising boards of public and private companies. She is the former Head of Capital Markets at Mayer Brown International and a director and trustee of a Kent hospice serving a community of approximately 750,000 people.

After qualifying as a solicitor in England and Wales in 1985, Stephanie worked in London with Rowe & Maw (now Mayer Brown) until 2011, specialising in corporate finance and mergers and acquisitions. She spent two years at Mallesons Stephen Jaques in Sydney, Australia and was admitted to the Supreme Court of New South Wales in 1989. Upon her return to Mayer Brown in London she became a partner in the Corporate Department. Stephanie joined the London office of Orrick, Herrington & Sutcliffe in 2012 as a partner in the Corporate group where she continued to advise companies and financial institutions, their boards and investors on a wide range of transactions. She was a senior member of the firm's Impact Finance Leadership team. After her legal career, Stephanie worked for two years with a venture capital fund, investing in early stage technology companies.

Stephanie led a multi-office Orrick team as co-author of *Balancing Purpose and Profit: legal mechanisms to lock in social mission for 'profit with purpose' businesses across the G8*, published by Orrick, UnLtd and Thomson Reuters Foundation in December 2014.

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Thanks also go to Sophie Hooper Lea for editing the text and Neil Pafford who prepared it for publication.

A Tribute to Peter Montagnon

When Philippa Foster Back told me that Peter Montagnon would be my main point of contact at the IBE for this publication, I admit I was rather daunted. He was a highly respected, veteran financial journalist and influential corporate governance advocate, and a prolific writer. This was to be my first foray into published authorship for several years. I need not have worried. I found Peter to be a kind, witty and generous supporter, who shared his insights freely while eagerly absorbing and challenging the technical legal analysis.

Unbeknownst to me, Philippa had tipped Peter off that I was learning Greek and when, on first meeting in July 2018, Peter launched into Greek for the exchange of the usual pleasantries, from which we progressed to discussing the olive harvest in Crete, I knew we would get on well. We met only a few times, to review my outline synopsis and, more recently, for Peter to give his feedback on the emerging detailed publication. Our collaboration proved tragically short. I had emailed my final draft of this Board Briefing to Peter the morning after his sudden and unexpected death.

Though our working relationship was brief, I am privileged to have had Peter's guidance and support in the preparation of this publication. I feel it captures accurately the sentiments and aspirations that Peter had wanted to relay, and I commend it to you. Peter was passionate about raising ethical standards in business and had great confidence that the introduction of S172 reporting would further the positive changes in behaviour at board level that he so hoped for.

Let us not disappoint him.

Stephanie Bates

IBE Foreword

There has been little focus on directors' duties since Section 172 of the *Companies Act 2006* (S172) became law. However, the banking crisis of 2008 and subsequent corporate failures have led to corporate governance, and directors' duties in particular, being revisited.

The Government's approach has included an emphasis on culture and values to underpin corporate purpose and strategy. S172 broadens a director's view in running a company with the key requirement to *"have regard (amongst other matters) to"*, which is particularly important now that large companies are required to report on S172.

This Board Briefing addresses the ethical dimension and what directors, individually and collectively, need to think about and report on. Linking company values to decision-making and S172 considerations helps businesses to become more successful and durable, while having a more positive impact on society.

I am grateful to our author Stephanie Bates for taking on this task and to others who have helped finalise it, following the sad death of our colleague Peter Montagnon.

This is the first publication funded by the IBE Supporters' Fund and we are grateful to the companies listed below. We hope others will be encouraged to contribute to this fund.

We hope you will find this seventh publication in our Board Briefing Series of value and, as ever, we would welcome your feedback.

Philippa Foster Back CBE
Director
Institute of Business Ethics

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Executive Summary

Doing the right thing makes for better business. Companies do not operate in a vacuum; they are an integral part of a delicately balanced system, and maintaining a healthy and vibrant system is in everyone's best interests.

Companies do not operate in a vacuum; they are an integral part of a delicately balanced system, and maintaining a healthy and vibrant system is in everyone's best interests.

The IBE believes that companies and society will benefit if company boards reach decisions that reflect sound ethical values and the interests of stakeholders in a more consistent way.

The board of directors is at the heart of a company and it is the board's task to ensure that the company has a sustainable future. This will only be realised if directors understand and foster the right relations with all those whom the company may affect, as well as those on whom the company relies. The board is responsible to the company, yet it needs to be responsive to those with whom the company interacts.

This principle is clearly recognised in the drafting of Section 172 of the *Companies Act 2006*, which sets out one of a number of codified duties of directors. S172 requires directors to act in the way that they consider would most likely *"promote the success of the company"* in the collective best interests of the shareholders, but in doing so they must *"have regard to"* the interests of other stakeholders, including employees, suppliers, customers and the environment.

This duty resulted from the work of the *Company Law Review*, initiated in 1998, which considered in some depth whether directors should owe their duties solely to their shareholders or to a wider group of stakeholders. The conclusion was the concept of 'enlightened shareholder value' (ESV).

The ESV approach maintained that the primary duty of a company director was to maximise value for the company's shareholders. However, it acknowledged that other relationships – with those such as employees, customers, suppliers and local communities – as well as the environmental impact of the company's activities and the company's public standing were significant in this and needed to be taken into account when determining how directors should discharge this duty. It is this concept that lies at the heart of S172 – directors must have regard to other stakeholders in their attempts to deliver shareholder value and also to the desirability of the company maintaining a reputation for high standards of business conduct.

While this duty has been codified in company law for over a decade, more recent concerns have led the UK Government to require boards to report on how they have discharged their S172 duty and, in particular, how they have had regard to their broader stakeholder community in their board decision-making. The new obligation is contained in *The Companies (Miscellaneous Reporting) Regulations 2018* and, for listed companies, in the most recent *UK Corporate Governance Code* published by the Financial Reporting Council (FRC).

The first reports under the new requirements are due in 2020. All large UK-incorporated companies that fall within the thresholds are required to report on how directors have fulfilled their duty under S172, even if they are subsidiaries of a UK or non-UK parent that is separately required to report on its corporate governance arrangements.

The new reporting requirements have not changed the legal duty of directors to *"act in the way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole"*. However, they are designed to encourage companies to be more open about who their stakeholders are and how the interests of those stakeholders have been taken into consideration in board decision-making. It is hoped that the reporting requirements will also encourage companies to review how they engage with their employees and other key stakeholders, and to consider new ways of doing so.

> *This is an opportunity for all companies to review how board decisions are currently reached and whether changes might improve the quality and integrity of those decisions*

The best run companies, which already take stakeholder interests into account, will only have to report on their existing board practices. However, the IBE sees the additional focus on S172 as an opportunity for all companies to review how board decisions are currently reached and whether changes might improve the quality and integrity of those decisions, as well as facilitating effective reporting.

The IBE has long voiced the need for companies to define their values, purpose and strategy as well as to promote appropriate behaviours within their organisation. Understanding how a board reaches and delegates decisions allows companies to make meaningful disclosures.

The hope is to discourage a box-ticking approach and instead encourage companies to see this as an opportunity for boards to demonstrate how they meet the requirements placed upon them. Trust in many of the key institutions that underpin society has declined, and there are significant variances in levels of trust in companies by geography and sector. The increased openness and transparency that the new reporting requirements encourage provides an opportunity for well-run companies to differentiate and enhance their reputation with key stakeholders.

The aim of this Board Briefing is to help companies benefit from the new reporting obligation, and to encourage them to go beyond legal requirements. It is intended to convince companies to reflect their values in decision-making and report on what they have done to define and embed appropriate standards of conduct across the organisation.

It is intended to be read by all directors, executive and non-executive, as well as company secretaries of companies to which the new reporting requirements apply. It should also be read by officers, managers and support staff who prepare board packs, reports and other briefing materials for directors, as they are also pivotal in the decision-making processes of successful larger companies.

> *Companies need to reflect their values in decision-making and report on what they have done to define and embed appropriate standards of conduct*

Introduction

This section provides background to S172, identifies opportunities within the new reporting regulations and explains what this Board Briefing sets out to achieve.

The evolution of S172

Over the years, the relationship between companies and society has been periodically revisited throughout the world. Most recently, it was considered in England by the *Company Law Review*, which produced its final report in July 2001. One of the areas of debate in the review was to whom the directors owed their duties. It was agreed that the board has a duty to promote the long-term health of the company.

There were two schools of thought as to how this was to be achieved. One school supported the concept of 'enlightened shareholder value' (ESV). In this case, directors would owe their duty to the company for the benefit of the shareholders but, in exercising that duty, would take into account the relationships that the company has with other stakeholders such as employees, customers and suppliers. The other school advocated a pluralist approach, where directors owed their duties to a broad range of stakeholders, which included the shareholders.

> *The 'enlightened shareholder value' approach was seen as a codification of existing best practice*

After some debate, it was recommended that ESV was the preferred approach. This was seen as a codification of existing best practice, on the basis that good directors would already have been paying due regard to a broad range of stakeholder considerations when making decisions. The pluralist approach would have required a more fundamental change in company law, to oblige directors to consider the interests of stakeholders in their own right. It was also rejected because it would have provided little guidance on how directors should balance those duties when making decisions.

The recommendations from the *Company Law Review* finally made the statute book in the *Companies Act 2006*, of which S172 is a vital part.

Prior to the *Companies Act 2006*, common law imposed other fiduciary duties and a duty of care and skill on all directors. The extent of those duties had evolved over centuries. Many of these duties were also codified by the Act in an attempt to make directors' duties clearer. Other statutes and regulations create additional offences, and many impose strict liability.

Decision-making after S172

The introduction of S172 provided boards with a clearer framework for decision-making. It requires directors to act in the way that they consider would most likely *"promote the success of the company"* in the collective best interests of the shareholders but, in doing so, they must *"have regard to"* a wide range of factors, including the interests of employees, suppliers, customers, the community and the environment.

S172 aims to encourage a culture where the wider consequences of decisions are routinely considered. This makes good business sense and, in many ways, reflects what forward-thinking, successful companies and their competent directors have always done.

Since the introduction of S172, the impact and influence on companies of a broader range of stakeholders has grown significantly. Yet it is important to note the clear distinction between engagement by companies with their shareholders (and creditors, if there is the prospect of insolvency) and relations with other stakeholders. The former are a board responsibility because, while their duties are owed to the company, boards are accountable to shareholders. While relations with other stakeholders (in particular customers, suppliers and regulators) are also critically important, the board's role – and particularly that of the non-executive directors (NEDs) – is more generally one of oversight, to ensure that those relationships are being properly maintained and managed. The executive directors on the board will play a critical role in this area. [1]

The new reporting requirement – an opportunity

A string of corporate failures in the UK in the 1980s and 1990s – such as Maxwell, Polly Peck and the Barlow Clowes pension mis-selling scandal, which caused significant harm to stakeholder groups – added to consideration of how the S172 duty could be enhanced and enforced. The *Company Law Review* was clear that, as the duty of directors was to the company for the benefit of its members, it was for the shareholders – in the name of the company – to enforce this duty. However, shareholder actions of this sort have been rare.

The most significant development has been the new reporting obligation that is contained in *The Companies (Miscellaneous Reporting) Regulations 2018* and, for listed companies, in the most recent *UK Corporate Governance Code 2018* published by the FRC, requiring the board's decision-making to be transparent. This reporting obligation will make boards think carefully about the effects of their decisions on the broader stakeholder community.

This is not simply about compliance. Companies do not operate in isolation; they are part of a delicately balanced system which, it is now accepted, includes a wider stakeholder group in addition to shareholders. Maintaining healthy and thriving relationships with a broader stakeholder base is in the best interests of the company and its shareholders. The reporting obligation is an opportunity for boards to demonstrate clearly that the companies they govern have values and culture that are focused on the long term and that they understand the societal context in which they operate.

“ *This is an opportunity for boards to demonstrate clearly that the companies they govern have values and culture that are focused on the long term*

[1] See IBE (2016) *Stakeholder Engagement: values, business culture and society* for more information

About this Board Briefing

In this Board Briefing, the IBE provides a 'refresher' on the current scope of S172 by considering each element of the requirements in turn. The vast majority of directors of large and successful companies will be well aware of their legal duties and already be thinking about the interests of their company's stakeholders in setting their strategic plans and growing their businesses for the long term.

This Briefing provides practical guidance for boards around making decisions as a group and answers a number of key questions about the new reporting obligation, highlighting issues for individual directors to consider. It is designed to help directors navigate through their own decision-making and their responsibilities for overseeing decision-making by management, giving consideration to ethical values in a way that will lead to meaningful reporting to stakeholders in the new S172 statement.

> *This Briefing answers key questions and highlights issues for directors to consider*

The New S172 Statement

It is now widely accepted that businesses perform better, and are more sustainable in the long term, when they have regard to broader stakeholder considerations in pursuing success.

Engaging with customers and suppliers; motivating and properly rewarding employees and considering the impact that a business has on the environment all make good business sense. Equally, failing to take into account, among others, the views of employees or local communities can be damaging to a business and its reputation.

S172 provides a framework for boards to consider a range of stakeholder considerations when making a decision. The requirements of S172 are set out below and each element is reviewed in turn in Chapter 2.

S172 – Duty to promote the success of the company

(1) A director of a company must act in the way he 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 (amongst other matters) to:

(a) The likely consequences of any decision in the long term

(b) The interests of the company's employees

(c) The need to foster the company's business relationships with suppliers, customers and others

(d) The impact of the company's operations on the community and the environment

(e) The desirability of the company maintaining a reputation for high standards of business conduct and

(f) The need to act fairly as between members of the company.

(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.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

Why did the Government introduce the new S172 reporting requirements?

Starting with companies with a financial year beginning from 1 January 2019, all companies of a significant size, whether listed or not, must explain in the strategic report within their annual report and/or on their website – via a separate, identifiable, annual S172 statement – how their directors have had regard to the matters set out in S172(1)(a) - (f) when performing their duty under S172.

The new reporting requirements flow from the Government's desire to reform corporate governance. Specifically, in relation to directors' duties, stronger reporting requirements should raise not only boardroom but also wider awareness of the duties of directors, and provide greater confidence that board decisions are being taken with regard to wider stakeholder interests. Companies failing to have regard to their stakeholders' considerations can have negative impacts on the wider economy that go beyond the immediate effects on the business itself. Examples could include avoidable pollution, an imperilled company pension fund or negative impacts on supplier businesses, all of which might have been mitigated.

As well as incentivising stronger stakeholder engagement, sustainability and long-termism, the Government anticipated that the benefits of the improved transparency from the new reporting requirement would also reduce the risk of future governance failures and help restore trust in business. [2]

> “
> *Companies failing to have regard to their stakeholder considerations can have negative impacts on the wider economy that go beyond the immediate effects on the business itself*

Which companies now have to report?

The Government is conscious of the importance to the UK economy of all large companies, whether or not they are listed. Failures in privately owned companies (like BHS) and listed entities (such as Carillion Plc) have shown the wider societal impacts of a breakdown in good governance.

Approximately 1,200 premium-listed companies and funds were required to report against the *UK Corporate Governance Code 2018*. By throwing the net more widely to include all 'large' UK-incorporated businesses, approximately 16,000 companies will be covered by the new S172 reporting requirements. [3]

In practice the requirement applies to 'large' companies, i.e. those meeting two out of the following three criteria:

- Turnover of more than £36m
- Balance sheet total of more than £18m
- More than 250 employees (whether or not UK based).

[2] Extracted from Department for Business, Energy & Industrial Strategy (BEIS) (2019) final *Impact Assessment on Corporate Governance Reform* – BEIS019(F)-18-BF

[3] Source: Bureau van Dyck FAME data

What should an S172 statement look like and who should 'own' it?

Companies have significant freedom in terms of how they wish to comply with the requirement to report. Boards must report on the practices they have in place to ensure that their actions (their own decision-making and their oversight of management decision-making) have had appropriate regard to stakeholder considerations, the desirability of the company maintaining a reputation for high standards of business conduct and the need to act fairly between shareholders.

There is no requirement to engage with stakeholders in specific ways. The Government recognises that the circumstances of individual companies differ and, as a result, so does the range of stakeholders that directors will need to consider. There is, however, an expectation that statements will include information for members on some, at least, of the following matters:

- **WHO** – outlining who the company considers to be its principal stakeholders and how it has formed that opinion
- **HOW** – describing the main methods the directors have used to understand the interests and views of these stakeholders
- **WHAT** – indicating the effect, if any, that the interests and views of the company's principal stakeholders had on decisions taken by the company.

The person best placed to make the S172 statement will be the Chair – as the individual responsible for leading the board – with the assistance, as appropriate, of the Company Secretary. The IBE recommends that corporate statements be published under the signature of the Chair, as this is likely to result in a more accessible and authentic statement.

The value of ethics

The IBE is clear that ethical values, which create an open and responsible culture, are key elements in effective governance. A board's core purpose is to promote the success of the company in line with its values. Boards that embrace ethical standards explicitly in the way they and the company operate are best placed to achieve the durable benefits that come from doing business ethically. Ethical values should lie at the heart of boardroom decision-making.

Fundamental to this is the tone from the top, which is set from the boardroom, and a clearly expressed code of ethics. [4] Many companies have identified their ethical values, but those values need to be thoroughly embedded in order for an organisation to become truly culturally distinctive. As the ultimate owners of a company's values, boards need to act as role models for the ethical values of their organisation. 'Walking the talk' is essential in creating a supportive environment for employees.

> *Ethical values should lie at the heart of boardroom decision-making*

[4] See IBE (2005) *Setting the Tone: ethical business leadership*

Some of the most commonly used ethical values

Responsibility Integrity Honesty Respect
Trust Fairness Openness Transparency

As much as a healthy culture is good for business, a poor culture presents a risk to the organisation as a whole – as demonstrated by this admission from Uber in its IPO prospectus in 2019:

> *"Challenges related to our culture and workplace practices and negative publicity we experience have in the past led to significant attrition and made it more difficult to attract high-quality employees."* [5]

Challenging times for board decision-making

Boards frequently have to make difficult decisions and address problems to which there is no single right answer, and many decisions are not specifically covered by law, regulation or formal company rules. A clear understanding of the company's values; its approach to risk and its perspective on the views of key stakeholders will help make better decisions, in line with obligations under S172.

Boards operate in an increasingly ambiguous and uncertain world, which can make board decisions ever more complex and difficult. Stakeholder considerations are more varied and the pressures to act unethically for short-term gain are high, but the consequences of getting it wrong can be more serious than ever.

A growing number of company boards have found it helpful to use an ethical decision-making framework or model that is rooted in the company's values. These pose sets of simple questions, which can be applied consistently at all levels throughout an organisation. See Chapter 4 for more information on ethical decision-making frameworks.

The Wates Principles

Recognising the importance of encouraging the highest standards of business conduct in large private companies, a new code for the corporate governance of these companies was launched in December 2018. It provides a framework to help companies meet legal requirements and to promote long-term success for this vital sector.

The *Wates Corporate Governance Principles for Large Private Companies* report was the result of *"concerted effort by a Coalition Group of diverse organisations representing a cross-section of interests related to private business"*. [6] The report offers six principles, which can be adopted by any company, to help them improve how they govern themselves as well as meet the new reporting requirements.

[5] UBER Technologies, Inc (2019) submission to the Securities and Exchange Commission (SEC)
[6] FRC (2018) *The Wates Corporate Governance Principles for Large Private Companies*

Principle One – Purpose and Leadership – advocates that values should be explained and integrated into the different functions and operations of the business. It recognises that a healthy culture is critical to the company's competitive advantage and is vital to the creation and protection of long-term value. A company's purpose and values should inform expected behaviours and practices throughout an organisation.

The five remaining principles are: Board Composition; Director Responsibilities; Opportunity and Risk; Remuneration and, finally, Stakeholder Relationships and Engagement. The report also suggests a number of indicators of corporate culture that can be tracked to help monitor corporate culture effectively. These include employee surveys; engagement with trade unions; absenteeism rates; exit interviews and board feedback sessions.

> *A healthy culture is critical to a company's competitive advantage and is vital to the creation and protection of long-term value*

The six principles of the *Wates Corporate Governance Principles for Large Private Companies*

Before turning to the key practical questions, it is important for boards to understand how S172 is constructed.

S172 Unpicked

S172 requires a director to exercise his or her duties *"in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole"*.

'Success' is not defined anywhere in the *Companies Act 2006*. During parliamentary debates in 2006 concerning S172, Lord Goldsmith remarked that *"the starting point is that it is essentially for the members of the company to define the objective they wish to achieve. Success means what the members collectively want the company to achieve. For a commercial company, success will usually mean long-term increase in value. For certain companies, such as charities and community interest companies, it will mean the attainment of the objectives for which the company has been established."* [7] In certain circumstances (looming insolvency being one) the interests of creditors take precedence over the interests of shareholders.

Success may be set out in the company's constitution and reflected in decisions made under it. In short, success for most investors in a commercial company means sustainable or durable, premium returns, with this implying 'in the long term' (i.e. beyond the planning cycle of the business). However, driven in part by growing awareness of geopolitical and climate change factors, there is increasing acknowledgement that companies do not operate in isolation. This change in stakeholder orientation and the consequent reduction in shareholder primacy is reflected most clearly in the Business Roundtable statement released in August 2019 – see below.

Business Roundtable *Statement on the Purpose of a Corporation*

In August 2019, the influential US Business Roundtable (chaired by Jamie Dimon, Chairman and CEO of JPMorgan Chase) announced the release of a new *Statement on the Purpose of a Corporation* signed by 181 CEOs who committed to lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders.

The statement was widely reported and attracted the support of other industry leaders, who cited the positive impact that the commitment will have on long-term value creation and the vital role that corporations can play in improving our society when CEOs are truly committed to meeting the needs of all stakeholders. [8]

At its simplest, such a broadening view of a company's purpose was perhaps long-overdue recognition that a company does not operate in a vacuum nor in isolation.

Nevertheless, while creating a sustainable business may lie at the heart of most board's strategic objectives, different companies will choose to face challenges differently.

[7] Lord Goldsmith (6 February 2006) Lords Grand Committee, column 255
[8] Business Roundtable (August 2019) *Statement on the Purpose of a Corporation*

For some companies, it may be quite right for short-term measures to be their priority from time to time (or even at all times). Dealing with an immediate issue such as greater competition, price wars or major changes in the regulatory landscape may call for a short-term focus. S172(1) goes on to state that in exercising those duties, a director must *"have regard (amongst other matters)"* to the six specific factors identified in Chapter 1 and in the sections below. These factors reflect the potential social and environmental impacts of the company's business that are relevant to the decisions that need to be made.

The B Corp movement

The increasingly influential B Corp movement – where companies are set up to balance purpose with profit – actively promotes its model of corporate governance as a way to combat short-termism. So far, there are over 3,000 certified B Corp companies worldwide. [9]

As the factors affecting the success of a company have become increasingly diverse, it is vital for directors to have a long-term as well as a short-term view in order to encourage and protect rational decisions. S172 provides a helpful framework for boards to 'have regard to' in their decision-making. This does not mean that these factors need to be dominant and determine the outcome of the board's decision-making, nor should these six factors be seen as exhaustive – there may be others that are relevant for consideration in particular circumstances. However, S172 does provide a starting point for the factors that boards should think about and give proper consideration to in their deliberations.

Taking each of the six factors in turn:

S172(1)(a) The likely consequences of any decision in the long term

Directors should address whether the decision under consideration will mean the business model and the anticipated financial and operational performance of the company is likely to remain attractive to investors over the longer term. Taking a short-term profit may be expedient and appealing for some shareholders, but will that decision prejudice or, worse, rule out future opportunities?

Such decisions will require a careful balance. The closing of a final salary pension scheme would be an example of a decision with both short and long-term implications. While it would offer immediate and ongoing annual cost savings and reduced risk for the company, it may make the company less attractive to both existing staff and employees who join after the decision is implemented.

> *Taking a short-term profit may be expedient and appealing for some shareholders, but will that decision prejudice or, worse, rule out future opportunities?*

[9] www.bcorporation.net

The difficult decision to vary dividend policy to reduce or cancel a company's dividend, or to undertake share buy-backs is another example. Boards have to balance the likelihood of a short-term hit to the share price against the risk of jeopardising long-term durability by maintaining unrealistically high levels of distributions of cash that would have been better deployed in the business. Carillion's board found this out to its cost, and it is notable that Thomas Cook was still paying dividends less than a year before its failure.

S172(1)(b) The interests of the company's employees

Companies often say that their greatest asset is their people. The Government is endeavouring to bring the voice of the employees into the boardroom. There is a clear requirement under S172 to have regard to the interests of employees.

The benefits of having a motivated and loyal workforce are nothing new, as noted by Cecil Parkinson MP (as he then was) during a debate in the House of Commons on 19 October 1976. On the first reading of an amendment to the Companies Act, he remarked: *"The successful company… will not think only of the interests of its shareholders but also about its workforce, the environment and its customers and consumers. It is only by thinking of these things that it will remain successful."*

Engaged employees will also help to attract others to join the company and contribute to its prosperity. Recognising employee interests in decision-making is a key part of building and maintaining this relationship. Companies that create an emotional attachment with their employees are more likely to succeed.

Directors need to ask themselves whether they are, in a continuous way, in touch with the workforce. There are now many ways in which boards can assess the culture and levels of engagement in their companies: internal measures such as employee surveys and exit interviews, and external forums such as GlassDoor. Boards will be better equipped to make decisions if they have had regard to the interests of employees.

> *Directors need to ask themselves whether they are, in a continuous way, in touch with the workforce*

The requirements of S172 have been supplemented by a requirement in the *UK Corporate Governance Code 2018* for quoted companies to consider one or more of three options for strengthening engagement with the workforce.[10] These are putting an employee on the board (often known as a 'worker director'), appointing a formal workforce advisory panel and/or having a designated NED to liaise with employees. The alternative is to set out the company's current system of employee relations on a 'comply or explain' basis. This new requirement, which came into effect in January 2019, will assist quoted companies in disclosing their decision-making. However, it could also provide some guidance on what all large companies – and, particularly, those who have to make a formal S172 statement – could do to improve engagement with employees.

[10] See Principle E of the *UK Corporate Governance Code 2018*

Worker directors – what some companies are doing

At least five UK-listed companies have chosen to appoint worker directors to their boards: FirstGroup, Capita, Mears Group, Sports Direct and TUI. [11]

Transport operator FirstGroup has had an employee director on its board for 30 years and the experience has reportedly been very positive. Current Group Employee Director Jimmy Groombridge, a veteran bus driver of 40 years, was appointed to the main board in 2017.

According to the *2019 Annual Report and Accounts*, the Group Employee Director:

- Promotes employee involvement and participation in the affairs of the Group, through share ownership, employee surveys and other means
- Identifies methods of achieving such employee involvement and participation and assists the FirstGroup Board to implement these
- Encourages suggestions from employees for improvements in the business of the Group and identifies how such suggestions can be evaluated and implemented where appropriate
- Considers the implications for the Group of political developments and initiatives, particularly in relation to transport policy and safety
- Considers issues of a strategic or commercial nature affecting the Group
- Promotes the Group's policies and procedures amongst employees, in particular those related to safety, diversity and inclusion, and business ethics
- Demonstrates and promotes the Group's Vision and Values amongst employees. [12]

Sports Direct, a company criticised not only for poor corporate governance but also for poor working conditions, appointed its first workers' representative to the board in April 2017. Alex Balacki, a 13-year veteran of the shop floor, was selected from the retail division and held office for a two-year term. The company's 2018 annual report included a short report from him. His successor, store manager Cally Price, was appointed in 2019.

Marks & Spencer has a long-standing employee panel – the Business Involvement Group (BIG) – which represents the interests of the 80,000-plus workforce. Following a successful pilot, the Chair of BIG is now invited to attend two board meetings and one remuneration committee meeting each year in order to *"share with us our colleagues' perspectives on the issues under discussion"*. [13]

Evidence suggests that far more companies are opting to designate an existing NED to represent employees. Examples include Diageo, Hays, Legal & General and Ted Baker.

[11] TUI is UK listed and German incorporated and so is distinguishable by its two-tier board structure, having a supervisory board with 50% employee representatives

[12] Extract from FirstGroup plc (2019) *Annual Report and Accounts 2019*

[13] See the *Chairman's Governance Overview* section of the Marks & Spencer plc (2019) *Annual Report & Financial Statements 2019*

There are some obvious challenges for worker directors in discharging their duties as directors under S172 (and, indeed, their broader duties as directors). The Times newspaper acknowledged some of the challenges when it reported in 2019 that the Institute of Directors *"was behind the principle of employee representation at board level, but it was worried about the exposure of worker directors to a conflict of interest or fiduciary duty if a company's leadership pursued a strategy such as cost-cutting that would be welcomed by shareholders but may be to the detriment of the workforce"*. [14]

S172(1)(c) The need to foster the company's business relationships with suppliers, customers and others

It clearly makes good business sense to treat suppliers, customers and other stakeholders fairly and to seek to establish relationships based on trust. (Note the change of language from S172(1)(b), where companies must have regard to the 'interests' of employees.)

Good relationships are crucial in business and will drive success. It is in these relationships that values and ethics can be used to mutual benefit and to build trustworthiness between parties. Clarity in these relationships will be key, as failures can lead to reputational and legal consequences.

A good relationship between a company and its suppliers is crucial and can have significant long-term benefits. It may be hard to find reliable suppliers in particular industries or sectors. Having found them, it makes good business sense to keep them on side. The kind of relationship a company has with its suppliers can influence that company's success. It can improve customer satisfaction, for one. Timely delivery of goods and services that are free from defects, appropriately sourced and not subject to modern slavery and other concerns will endear a company to its customers. Companies that settle their bills when due; place orders efficiently and in good time; are respectful to their supplier's sales representatives; communicate well and are transparent will build trust with their suppliers. These are all good elements of success. By contrast, paying late is a way to quickly break this trust.

> *A good relationship between a company and its suppliers is crucial and can have significant long-term benefits*

Late payment

Payment delays undermine a company's ability to take on additional business or invest in new productive capacity. Following the collapse of numerous high street retailers in 2018, the UK Government's BEIS Committee found fault with many large high street companies for imposing long supplier payments arrangements. Many took an average of 60 days to pay invoices. WH Smith, Boots UK and Holland & Barrett were identified by the Committee as having long payment terms.

[14] The Times (May 6 2019) *Capita set to join club of companies with worker directors on the board*

At the time of writing, a further consultation regarding proposed new powers for the Small Business Commissioner is due to take place. [15] The new powers could include the ability to tackle late payments through fines and binding payment plans. The Commissioner will also take responsibility for the voluntary *Prompt Payment Code*.

Turning to customers, businesses would do well to spend as much time considering customer satisfaction levels as they do customer complaints and keep the board well informed about both. Boards might usefully ask themselves whether they feel that data reported to them provides the required clarity and transparency.

> *Businesses would do well to spend as much time considering customer satisfaction levels as they do customer complaints and keep the board well informed about both*

Trust between businesses and the customers they serve is key. This is particularly so in the fund management industry, given the example in 2019 of the illiquid nature of some of the investments held in funds managed by Neil Woodford and revelations about how fund composition rules had been met.

Recognising and rewarding loyalty is more likely to foster relationships with customers than seeking to exploit customer apathy through techniques such as preferential offers to new savers.

There are many cases of businesses trying to entice new customers with attractive offers that are not available to existing customers, despite the fact that it is often cheaper to retain an existing customer than to win and 'onboard' a new one. Mobile phone companies as well as car and home insurers are examples of companies using this type of approach. It is far better for the directors to have debated the matter and concluded that all customers should be given a choice at the end of their initial contract or policy period, than to have the regulator step in and impose change. Some insurers do seem to be taking action before the regulators do: Aviva, Saga and RSA have all launched products designed to improve customer loyalty (see box below).

Good practice in customer service

Aviva has recently launched AvivaPlus, which is available for car and home insurance. Existing customers will be treated the same as – or better than – new customers. *"People are frustrated that they don't feel rewarded for loyalty, and you are penalised for it. We want to keep customers and make them feel rewarded,"* Blair Turnbull, head of Aviva's digital business, told the Financial Times newspaper (FT).

Saga and **RSA** have also introduced 'fair' price guarantees on policy renewals. Duncan Minty, insurance ethics adviser, is quoted as saying the policies were a positive first step but that it would require the regulator to force the market to change. [16]

[15] See www.gov.uk/government/organisations/small-business-commissioner

[16] FT (31 May 2019) *Insurers take action to reward loyal customers as pressure grows*

The 'others' referred to in S172(1)(c) have not been officially defined, as the list of matters (a) - (f) is itself non-exhaustive. Boards should use this as an opportunity to consider who the stakeholders of the company actually are.

S172(1)(d) The impact of the company's operations on the community and the environment

> *Companies do not exist in isolation – they depend on society for their franchise and, therefore, they need to foster relationships of trust with their stakeholders*

Companies are well aware of the community or communities in which they operate, whether local, national or international. There is a clear need to have regard to what impact the company's activities may have on them in the short or the long term. It is society that gives business its licence to operate and society has expectations that it places on business. It is simply good business sense for companies to understand this and be responsive to it. The IBE has argued previously that companies do not exist in isolation – they depend on society for their franchise and, therefore, they need to foster relationships of trust with their stakeholders. [17]

A decision by a company to move its production from the UK to a country with lower labour costs will result in redundancies and potentially wider job losses due to the knock-on impact on the company's supply chain. In considering such a proposal, the directors would want to have regard (among other matters) to the pre-existing level of unemployment in the area to assess what impact the proposed closure of the facility will have on the local community. Will the closure and redundancy programme adversely affect the company's reputation and ability to do business?

Impact on local communities

Companies that have a considerable impact on the local environment and/or nearby communities, for example the extractive industries, have a particular need to be sustainable in the long term and to minimise harm. They therefore need to think carefully about the communities in which they operate. One option would be to launch a local community engagement programme.

Concern for the environment should also be part of board deliberations and corporate decisions. Public perceptions of environmental practices have shifted dramatically in recent years. Since 2018, Greta Thunberg has motivated tens of thousands of young people to take to the streets in protest against climate inaction. Meanwhile, the Extinction Rebellion 2019 protests in London brought much of the city to a standstill. The IBE's own survey work of the British public also indicates that *"environmental responsibility has significantly regained focus as an issue for the British public"*. [18]

[17] IBE (2016) Op cit

[18] IBE (2018) *Attitudes of the British Public to Business Ethics 2018*

> *Concern for the environment should also be part of board deliberations and corporate decisions*

Public discourse has shifted from a debate about the existence of climate change to a realisation of the scale of the challenges ahead. As a result, companies are spending more time assessing the impacts of environmental issues on their own business model.

A growing number of NGOs and pressure groups are actively engaging with companies and the investment industry to promote responsible investment. They encourage investors to drive positive change in companies and their wider investments by focusing on the long-term impact they have on the environment and society. This focus is supported by the *UK Stewardship Code 2020.* [19]

Environmental damage

The consequences of environmental issues for companies are increasingly severe. Southern Water was recently fined £126m by the Water Services Regulation Authority (Ofwat) for *"serious failures"* including *"deliberate misreporting"* of data and the dumping of untreated effluent into beaches, rivers and streams, with *"scant regard for its responsibilities to society and the environment"*. The company now faces a criminal investigation by the Environment Agency (EA). In its report, Ofwat highlighted that Southern Water had failed to invest in its sewage treatment plants even after it breached EA pollution permits, *"suggesting failures in the investment decision processes within Southern Water"*. [20]

S172(1)(e) The desirability of the company maintaining a reputation for high standards of business conduct

Directors have to set the tone from the top; through values, codes of business ethics and, most importantly, through their behaviour. If boards want to 'do the right thing', then ethical values need to form the basis of any and all the decisions they make.

Much of this agenda is dictated by compliance, with an ever-growing number of regulations and laws. For example, in the areas of anti-bribery and corruption; anti-slavery; internal fraud controls; health and safety; environment; competition law compliance and anti-discrimination concerns. However, compliance with the letter of the law is not enough. While boards must establish rules to ensure that the letter of the law is followed, many decisions are made against a background of ambiguity and uncertainty.

> *Directors have to set the tone from the top; through values, codes of business ethics and, most importantly, through their behaviour*

19 FRC (2019) *The UK Stewardship Code 2020*

20 Ofwat (25 June 2019) PN12/19 *Southern Water to pay £126 million following Ofwat investigation*

Boards need to exercise judgment to ensure that the spirit of the law is met as well. A strong ethical foundation for the board's deliberations in grey areas will ensure that the exercise of that judgment is values-led.

Boards can build a reputation for high standards of business conduct by demonstrating, through their own actions, how employees can do business ethically. Boards should be setting a high standard that demonstrates commitment to living up to the company's values. This requires a different mind-set. Compliance is about meeting standards set externally, whereas the standards required to meet a company's internal ethical framework are much closer to home. Ian Durant, Chairman of Greggs, describes culture as *"how it feels to work here"*. [21]

A strong values-based culture should be empowering and aspirational; embedding it requires winning over hearts and minds. Compliance programmes on their own are often about preventing colleagues from doing the wrong thing (by telling them what not to do), whereas a strong business ethics framework will support them in doing the right thing.

Reputations are hard won and easily lost, so boards need to be very alert to how they behave.

The power of pressure

Companies and brands can face extreme, international scrutiny from organisations such as non-governmental organisations (NGOs), pressure groups and the media. Stakeholders can find out more detailed information than ever before about corporate behaviour. Ethical Consumer magazine, for example, has ranked 40,000 companies on the basis of 300 different business ethics topics. [22] This availability of information has the potential to impact considerably on corporate reputations and to increase pressure on companies that fail to live up to their values.

In reality, boards take few decisions compared to the many decisions that are taken under delegated authority by, first, the chief executive and then those who report to the chief executive as authority is cascaded down through the organisation. It is important that, through its committees and the executive team, the board has the right oversight of decisions that are taken. The idea of having a committee dedicated to the task of overseeing culture and ethics is relatively new, but is one way in which companies are approaching this task. This allows directors to drill down more systematically into the detail of culture and ethics, thereby identifying patterns of behaviour that might elude a busy board. As a result, the committee will provide more complete assurance that the right systems are in place to address the growing range of non-financial risks. [23]

[21] Independent Audit (2016) *Cultivating Culture: what boards can and can't do about behaviour*

[22] www.ethicalconsumer.org

[23] This point is beyond the scope of this Board Briefing, but has been discussed in IBE (2016) *Culture by Committee: the pros and cons*

S172(1)(f) The need to act fairly as between members

S172(1)(f) requires fair treatment between different classes of shareholder. This has particular relevance for unlisted companies with different classes of shares. This requirement helps to ensure that minority shareholder interests are considered by directors.

The requirement to act fairly between shareholders is an important ethical challenge for directors, balancing the differing needs of institutional and retail shareholders, and ensuring fair play.

> *"The requirement to act fairly between shareholders is an important ethical challenge for directors*

Engaging with retail shareholders

In addition to its active engagement with the workforce through its employee panel, Marks & Spencer set up a Private Shareholder Panel (PSP) in 2016 to engage with its retail shareholders. Meetings between the PSP and members of the Operating Committee Board and senior leadership facilitate engagement with these important shareholders. [24]

The Chartered Governance Institute (formerly ICSA: The Governance Institute) and The Investment Association have attempted to address this challenge. A guidance note published in 2017 articulated ten core principles aimed at helping *"company boards think about how to ensure they understand and weigh up the interests of their key stakeholders when taking strategic decisions."* [25] These ten core principles are:

1. Boards should identify, and keep under regular review, who they consider their key stakeholders to be and why
2. Boards should determine which stakeholders they need to engage with directly, as opposed to relying solely on information from management
3. When evaluating their composition and effectiveness, boards should identify what stakeholder expertise is needed in the boardroom and decide whether they have, or would benefit from, directors with directly relevant experience or understanding
4. When recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria
5. The chair (supported by the company secretary) should keep under review the adequacy of the training received by all directors on stakeholder related matters, and the induction received by new directors, particularly those without previous board experience
6. The chair (supported by the board, management and the company secretary) should determine how best to ensure that the board's decision-making processes give sufficient consideration to key stakeholders

[24] https://corporate.marksandspencer.com/investors/shareholder-information/faq/shareholder-panel

[25] ICSA: The Governance Institute and The Investment Association (2017) *The Stakeholder Voice in Board Decision Making: strengthening the business, promoting long-term success*

7. Boards should ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review
8. In designing engagement mechanisms, companies should consider what would be most effective and convenient for stakeholders, not just the company
9. The board should report to its shareholders on how it has taken the impact on key stakeholders into account when making decisions
10. The board should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.

Limited liability and subsidiary governance

Companies are recognised in law as separate legal entities from their owners. All debts incurred by a company are the company's liabilities and are not directly the legal liabilities of the shareholders or the directors of the company. In a company limited by shares, the shareholder's obligation is to pay the company for the shares they subscribe for. Provided the shares are fully paid, no further money is payable by the shareholders. Therefore, only any capital committed to the company as share capital is liable to be lost if the venture fails.

As corporate groups began to emerge, this principle was extended to subsidiary companies. Parent companies were regarded as completely separate legal entities from the subsidiaries they controlled and were often wholly owned and therefore entitled to the protection of the laws on limited liability. Complex corporate groups emerged with layers of parent, subsidiary, sub-subsidiary and associated companies each being a separate legal entity whose shareholders (other group companies, typically) benefited from limited liability. Again, typically, common directors inhabit the boards of these group companies. So even where a parent company has effective control of a subsidiary whose directors may be the nominees or even the same persons as the directors of the parent, each company enjoys limited liability.

A director of a subsidiary group company owes their duty under S172 to the subsidiary company of which they are a director, not to the group parent company (even though they may also be a director of the parent). The interests of parent and subsidiary will very often be closely aligned. When acting in the role of subsidiary director, directors should focus on the interests of that subsidiary and its success when weighing up S172 considerations. That said, the views of parent companies are usually important and appropriate factors to take into account.

> *A director of a subsidiary group company owes their duty under S172 to the subsidiary company, not the group parent company*

> *There is an opportunity for the UK to develop greater understanding in the business community about subsidiary governance, which has hitherto been a neglected area*

In the IBE's response to the consultation by the FRC on the *Wates Corporate Governance Principles*, it was pointed out that *"there is an opportunity for the UK to develop greater understanding in the business community about subsidiary governance, which has hitherto been a neglected area. Issues include personal and corporate conflicts for the subsidiary directors between duty to the company and its stakeholders and their duty to the parent, related party transactions and transfer pricing."* [26]

For instance, a not uncommon scenario is interdependency on group financing arrangements that, but for the strength of covenant of the parent company, would not be available to the subsidiary.

What is key for the boards of holding companies is, while respecting the corporate veil, to ensure that values and the need for ethical behaviour are recognised by the directors of subsidiaries.

[26] IBE response to FRC (2018) consultation on *The Wates Corporate Governance Principles for Large Private Companies*

A Dozen Key Questions Answered

This section addresses some of the key questions that raise practical considerations for boards when discharging their obligations under S172.

Q1. Do I really have to consider each of those matters for *all* board decisions?

S172 applies to anyone in their role as a company director and to all decisions in the governance of a company's affairs. It makes no difference whether the decisions taken are material or immaterial, formal or informal, or whether they are taken individually, as a committee or by the full board. So directors need to know all of their duties and to understand what they need to do to discharge them. Boards will need to identify the stakeholders that are relevant to a particular decision and identify other interested parties whose views might inform the debate. The decision that the board reaches will need to have had due regard to all relevant factors.

It will be straightforward for directors to have proper regard to their duties under S172 for many formal items of business (for example, the approval of financial statements, recommending dividends and board appointments). Here, carefully prepared papers will be provided, proper processes are routinely adopted and the stakeholder considerations are clear (for example, shareholder expectations for dividends are an essential part of the board determination of dividend policy). The directors must be satisfied, of course, that they have enough information on which to base a decision.

“S172 applies to anyone in their role as a company director and to all decisions in the governance of a company's affairs

How directors perform their functions varies widely depending on the particular issues and the company concerned. In larger companies, many more decisions are delegated to management and employees in the context of a framework of high-level strategies, statements of risk appetite and policies approved by the board. In setting and reviewing the elements of that high-level framework, the directors must have regard to S172 and all relevant factors. In unlisted and smaller companies, directors may be more involved in more individual day-to-day decisions.

It is vital to define the matters that will be reserved for the board, to ensure that all material decisions (including those likely to raise significant S172 challenges) are reviewed at a board meeting. The level of materiality that is appropriate will depend on the nature of the company and the desire to ensure that boards operate at a strategic level. Where a particular decision is being taken to the board, the board must have confidence that they have all the relevant information at the time of a decision. Where decisions are delegated, the directors must have effective oversight of those decisions. They need to be sure that the decisions are being taken by individuals with the right level of seniority, experience and expertise, and that those decisions are properly informed by relevant stakeholder considerations. In setting these standards, the board will need to be clear on how they view the requirements of S172.

Key questions for boards to consider:

- Does the company's framework of high-level strategies, statements of risk appetite and policies properly reflect an appropriate range of stakeholder considerations?
- Does the company's scheme of delegation ensure that relevant stakeholder considerations should be taken into account when individual executives are exercising their authorities?
- Which stakeholders will be most affected by or have the most relevant input into this particular decision?
- Are there other stakeholders that the board would not ordinarily hear from, who are relevant to this particular decision?
- What mechanisms does the board have in place to capture input from these stakeholders? Are those mechanisms sufficient to inform the board adequately for this decision?
- Have the board papers adequately captured this input?
- Has the board fully reflected the views of these stakeholders in the record of its deliberations and the basis of its decision?

Q2. What about decisions that the board have delegated to management?

The day-to-day management of a company is invariably delegated to the board by its shareholders under the articles of association. Directors are initially appointed by the shareholders and can usually appoint additional directors up to any limit set by the articles. The board may – if the articles allow, which they generally do – delegate powers to board committees.

Most importantly, however, the articles will also allow the board to delegate the day-to-day running of the company to the chief executive or managing director, with the power to sub-delegate through a scheme of delegated authorities. Large, global companies could not function, let alone succeed, without that high degree of delegation. It is both necessary and expedient.

> *Delegation of authority does not absolve directors from their individual responsibilities under S172*

However, even where the majority of decisions are delegated to management through the chief executive, there does need to be an effective system of oversight and monitoring in place, to enable compliance with S172. Delegation of authority does not absolve directors from their individual responsibilities under S172. Directors must be aware of what is being done in the company's name by employees and other staff, as well as by agents authorised to act in the name of the company. It is important that proper systems of reporting and control are in place to provide peace of mind to the directors, because they are ultimately responsible for the actions of staff. In most large companies, a carefully constructed scheme of delegation should help demonstrate that the directors are exercising their duty correctly, but it will not be enough on its own.

Other duties – independent judgment

How does delegation sit with the duty of a director to exercise independent judgment, as set out in S173 of the *Companies Act 2006*? There is no inconsistency. Directors may delegate certain matters to individuals with specialist expertise. However, in doing so, they must exercise independent judgment. For example, if directors choose to delegate a task to a sub-committee of the board, they must exercise judgment in setting the terms of reference of the sub-committee and in deciding whether or not to follow its advice and recommendations.

Boards want to influence behaviour so that employees make good decisions, even under pressure. The culture of the company is key, and boards have a vital role in establishing a culture that not only stops people doing the wrong thing, but empowers and encourages people to do the right thing. The board needs to establish ethical values supporting the core purpose of the company, embed those in the business and drive the right behaviours. Boards need to role model a supportive culture, where concerns can be raised openly, in confidence that they will be acted on.

> *Directors cannot get a full impression of what is really happening in the business just by sitting in the boardroom and reading carefully prepared papers*

As made clear by Sir Winfried Bischoff in the FRC's report on corporate culture, the whole board has a responsibility to go beyond compliance: *"The strategy to achieve a company's purpose should reflect the values and culture of the company."* [27] All board members have a shared role to set the tone of 'how' to do business. While specific tasks – such as running an ethics programme – will be delegated to certain individuals, the overarching culture of doing business ethically is everyone's responsibility.

Taking the temperature of the organisation is key. To properly understand and influence the culture of a company, directors need to have some familiarity and direct contact with people throughout the company (as well as, if possible, suppliers and customers). One participant in previous IBE research described this as a need to *"get out and kick the tyres"*. [28] Directors cannot get a full impression of what is really happening in the business just by sitting in the boardroom and reading carefully prepared papers. If they get out and meet people throughout the company, their decision-making will be more informed and, hopefully, better. Good decisions about strategy and products, for example, can move a business to the next performance level.

[27] FRC (2016) *Corporate Culture and the Role of Boards: report of observations*

[28] IBE (2014) *Ethics, Risk and Governance*

Bringing S172 to life in a company requires the board to have more direct interaction with a variety of stakeholders, beyond the meeting with senior regulators and institutional shareholders that boards will already be familiar with. This can be a delicate area, as it is not for the NEDs to be involved in the day-to-day management of the company. If direct contact with suppliers and customers is not appropriate, then other means of better understanding their issues and expectations will need to be found.

In this respect, it will be important for the board to understand their collective responsibility in these areas and for the executive directors to find ways for their non-executive colleagues to gain access to the appropriate information that is in their mutual interest.

Key points to consider:

- Is the scheme of delegation through the CEO clear? Are the directors happy that the matters reserved for the board will ensure that all material discussions will come to the board?
- Are the terms of reference for the board committees clear so that the directors properly understand what decisions (if any) can be taken at a committee level?
- What assurance do the board have that the scheme of delegation is robust and operating effectively? For things that have gone wrong, what have the board learned (for example, about the level or place in the organisation at which a poor decision was taken) and how has that influenced revision of the scheme of delegation?
- Are there discussions and decisions that have previously been delegated to management but that ought, on reflection, to be reserved to the board?

Q3. How should the board prioritise between competing or conflicting interests?

The law does not assign priorities to the range of interests that directors must consider under S172. A director's job is to weigh up all the relevant factors, establish what is most important and then exercise judgment to decide which course of action will best lead to the long-term success of the company.

The fact that certain stakeholders may be unhappy with the decision does not mean that the decision is wrong. As an example, some shareholders will have only a short-term interest in the company's success, but the board will need to balance those considerations, having regard to them in pursuit of the success of the company for shareholders as a whole.

Difficult judgments will always need to be made, but the quality of that decision-making will be better if all the potential consequences are considered. This may not be straightforward. Bear in mind, as well, that directors owe their duties to the company as opposed to shareholders or other stakeholders.

A director's job is to weigh up all the relevant factors and then exercise judgment to decide which course of action will best lead to the long-term success of the company

Lawmakers were clear that they did not want to create a situation in which there could be endless litigation about the decisions reached by directors. This might otherwise be the case where, for example, different stakeholder groups have conflicting interests or one group think that their concerns have not been adequately considered. In that circumstance, commerce would grind to a halt and no-one would be willing to take on the role of director.

Key points to consider:

- Are the stakeholder views that are being expressed most vocally truly representative?
- Have the board heard from all relevant stakeholders?
- Are there negative long-term implications arising from a course of action that is attractive in the short term?

Q4. Should the views of a majority shareholder carry more weight?

The director's duty is to form a good faith judgment about what success looks like for the members as a whole, not just the majority shareholders, any particular shareholder or a section of shareholders. This informs or becomes the directors' strategic goal.

As mentioned earlier S172(1)(f) requires fair treatment between different classes of shareholder.

Listed companies almost invariably have many types of shareholders with different interests, and effective engagement is a challenge given the highly dispersed nature of share ownership and the trend towards passive rather than managed funds. [29] The changes in shareholder structure have produced what have been described as 'ownerless companies', where no single investor has a sufficiently large or long-term stake in the business to act as a responsible owner, checking performance and behaviour. As Andy Haldane of the Bank of England has stated: *"One consequence of a more dispersed and disinterested ownership structure is that it becomes harder to exert influence over management, increasing the risk of sub-optimal decision-making."*

> *The director's duty is to form a good faith judgment about what success looks like for the members as a whole*

Another significant development has been the success of activist investors taking comparatively small investments in listed companies and very skilfully leveraging those minority stakes to exert considerable influence on the board. In those situations, boards need to balance the risks of appearing to be complacent with the need to act in the best interests of all shareholders, not just addressing the short-term aims of the activists. Boards must put the reputation and success of the company at the forefront of their decision-making and not be distracted by considerations of their own individual reputations.

Therefore, the requirement to act fairly between members is an important ethical challenge for directors.

[29] BEIS Committee (2017) HC702 *Fourth Report of Sessions 2016-17* para 48

Shareholders come in many different guises. Do you know who your shareholders are?

The term 'shareholder' is often taken to mean those exerting short-term pressure in the market. This is manifestly incorrect. In discharging their duty to act fairly between these different groups of shareholders, directors may have to stand up to short-term speculators in the interest of long-term shareholders.

A large private company may be a wholly owned subsidiary of its parent company – meaning that it only has one shareholder. A family-run company of similar size may have several classes of shares and a multitude of shareholders including trusts; past and present employees; NEDs; commercial partners and family members with no involvement in the business, to name but a few.

Quoted companies will likely have many different categories of shareholders – retail; long-term institutional; traders; controlling; minority; incentive plan participants; hedge funds, etc. as well as passive investors via tracker funds; active investors; overseas shareholders; employee shareholders, etc.

Key points to consider:

- Even for wholly-owned subsidiaries, boards should consider whether the course of action proposed by the parent company is in the best interests of the subsidiary; the board owes its duties to the subsidiary company not the parent
- Are the board hearing the range of stakeholder views required to properly inform its decision or is the voice of the majority shareholder or the activist shareholder inappropriately dominant?

Q5. I am a non-executive director. Surely the executive directors have a greater responsibility here?

The duty under S172 applies to each individual director, regardless of their role on the board.

NEDs or independent non-executive directors (iNEDs) are not involved in the day-to-day management of a company. That is the role of the executives, who have management responsibility for specific functions within a company, each deriving their authority from the authorities delegated to the chief executive.

Executives who are also board members (typically the CEO and the finance director) wear two hats: they are members of the board, with identical responsibilities to the NEDs, but they are also senior individuals with significant delegated authorities to make day-to-day decisions on behalf of the company.

This, of course, affects the dynamic in the boardroom. As a practical matter, executive directors have a more detailed understanding of, and familiarity with, the way in which the company operates on a daily basis, even if ultimately all directors have equal responsibility.

On S172 matters and, indeed, much more widely, individual executive directors have a very significant opportunity to help the overall dynamic of their boards by ensuring that board papers and other reporting to the board reflects the operational environment of the company and the stakeholder considerations that are relevant.

In practice, the roles played by directors differ significantly depending on the size of the company and whether it is part of a wider group.

The role of a NED is often said to be 'to support and challenge' the executives responsible for the day-to-day running of the company and develop proposals for strategy. Under Principle H of the *UK Corporate Governance Code 2018*, NEDs *"should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account."*

The role of NEDs

NEDs are expected to make reasonable enquiries of the company's executives to satisfy themselves that the executive directors have:

- Demonstrated a commitment to legal and regulatory compliance throughout the company
- Taken appropriate steps to identify and assess the company's exposure to key legal and regulatory risks specific to the business
- Taken appropriate steps to mitigate those risks, including appropriate training activities, policies and procedures
- Reviewed the company's commitment to compliance, risks and mitigating activity on a regular basis.

> *Directors are expected to have the standard of skill and knowledge that is appropriate for their position and the nature of the company in question*

In all cases, however, company directors are expected to demonstrate a clear understanding of their company's activities; financial position; responsibilities and liabilities as well as their own duties and legal obligations. Directors are expected to have the standard of skill and knowledge that is appropriate for their position and the nature of the company in question.

Directors are also expected to update and refresh their knowledge on an ongoing basis. For example, an executive director with responsibility for sales or for setting prices would be expected to take (or ensure that his or her company was taking) steps to identify, assess and mitigate any potential areas of competition law risk – such as cartel activity – that may arise in connection with that area of the business.

Do I need to be an expert?

NEDs will not be expected to understand the detailed application of, say, copyright law, competition law or financial services regulations – unless they have expertise in a specific area, in which case they will be expected to use that knowledge. However, NEDs do need to have sufficient understanding of key issues that relate to the company, so that they can recognise risks and know when to make further enquiries or seek legal or other advice. For example, the NEDs of a record company would be expected to understand copyright protection, while those of a construction company would not.

Key points to consider:

- Are the executive directors on the board helping the non-executives by providing the necessary bridge to best understand the operational context and stakeholder dynamics for the decisions that the board are considering?
- Do individual directors know all that they need to know about the business, law and regulation to understand the key issues for the company and to help them identify and assess the material risks that the company faces? Is the company doing enough to help individual directors stay up-to-date and properly informed?

Q6. What if I disagree with my fellow directors?

Directors' decisions are taken collectively by the board. A director cannot act alone (unless he or she is a sole director). When taking a decision, a director must exercise his or her own judgment. One of the benefits of having a diversity of views among directors is that differing opinions can be expected. Because the law imposes a subjective test on a director – to act in what they believe to be the interests of the company – there is not an objectively right answer as to what is in a company's best interests.

Most of the time boards reach big decisions by discussion, debate and refinement of a proposal, resulting in a consensus that every director is willing to support. Differences of opinion around the boardroom table help shape that consensus and compromises are made to find a middle ground. Diversity of thought and experience among the directors is vital to refining and improving the proposal. At the end, even if individual directors would each have preferred a slightly different outcome, they are prepared to live with the final consensus.

Even if it comes to a formal vote of the board, as long as there has been a proper process and attendance, then the fact that a director disagrees with a board decision does not affect the legitimacy of that decision. The general rule is that board decisions are made by majority vote. Articles of association usually state that resolutions will be passed by a majority of those who are present and voting at a board meeting or by a written resolution signed by all the directors.

The articles may, however, confer a casting vote on the chairperson. The chair does not have a casting vote unless the articles permit it. The principle of 'cabinet collective responsibility' applies if a vote is held. Once a proper resolution of the board has been passed, the courts have decided that it is the duty of all the directors, including those who took no part in the deliberations of the board and those who voted against the resolution or abstained, to implement it.

Sometimes, however, achieving an uncomfortable consensus or pushing through a majority vote is not enough. A good chair will sense those big decisions that require unqualified, unanimous support around the table and may even call for a formal vote of the directors. These decisions are usually on major matters of strategy, where the outcome will shape the future agenda for the board and where any subsequent reopening or questioning of the decision would be damaging for the board going forward.

Often it will be difficult, if not impossible, for a dissenting director to stay on the board to implement a major decision that they have fundamentally disagreed with and voted against.

The role of the chair

The *UK Corporate Governance Code 2018* states in Principle F that:

> *"The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information."*

> *Given the role of the board in setting the ethical tone for a company, resolving ethical differences is of enormous cultural significance*

However, the same tensions can also arise for a dissenting director who has an ethical objection to a proposal, even if that proposal does not relate to a major aspect of strategy. The heightened focus on S172 means that the inevitable compromises involved in trying to address conflicting stakeholder needs will be more visible for boards. Ethical dilemmas for individual directors are likely to arise more frequently.

Ethical matters are rarely crystal clear, and it is quite possible for two directors with equally high standards of personal integrity to fundamentally disagree on the actions that should be taken. Given the role of the board in setting the ethical tone for a company, resolving those differences is of enormous cultural significance. Dissenting directors should not feel that resigning is their only option.

Individual directors will need to frame their objections carefully and be clear when they are dissenting to a proposal on ethical grounds. Without compromising their authority, chairs will also need to be more sensitive to these situations and judge when unqualified unanimity is required from the board. Chairs should be prepared to push back for reconsideration by management any such proposal where a dissenting director cannot be convinced through debate, ensuring that the re-worked proposal is one that can earn the unanimous support of the board.

The minutes will usually record the board's resolution, rather than the votes of individual directors. If a director feels particularly strongly about the matter, then they can – and arguably should – request that the minutes of the meeting specifically record how they voted (or abstained from voting) on the proposal.

It is a director's prerogative to resign, but board resignations on points of principle are rare. It would be unusual for a director to resign from the board simply because they were in the minority in not supporting a proposal. If the decision is so egregious or divergent from that director's principles, then resigning may be the only proper course for them to follow. Perhaps better – and more consistent with the duty to promote the success of the company – would be for the director to remain on the board and continue to voice their opinion; constructively challenge their co-directors; exert their influence and so discharge their duties. This requires courage and, ideally, support from co-directors. It will help the dissenting director, the chair and the rest of the board if the company already has a clear ethical framework against which the disagreement can be reviewed.

The role of a director can be a lonely one. There are times when it will take courage to choose the correct course of action, particularly if it comes at the expense of individual popularity.

Key points to consider:

- If a director has a fundamental objection to a proposal, is it clear whether the objection is on ethical grounds or for some other reason? Has the director made their ethical objections clear to the chair and to colleagues on the board?
- Is the majority view of the board clearly in line with the values of the company?
- Do the minutes properly reflect the position put forward by any dissenting director?
- When is it appropriate for a director or chair to resign? What if they have serious misgivings about other board members' commitment to corporate governance?
- Before resigning, have a dissenting director and the chair exhausted every other opportunity to avoid that outcome?

Q7. To whom do we owe our duties and how will we be judged?

In normal circumstances, directors owe their duties to the company and not to individual shareholders or to other stakeholders. The only requirement for boards will be to have due regard to the interests of those stakeholders (as well as the desirability of the company maintaining a reputation for high standards of business conduct and the need to act fairly between shareholders) when discharging their obligation under S172, in order to promote the success of the company for the benefit of its members as a whole.

Only the company can enforce these duties. Directors are liable to the company for loss to the company, and not more widely. There are limited exceptions. Shareholders have the right to bring derivative actions in the company's name against a director, as long as they meet the substantive and procedural thresholds to bring a claim. There are also statutory and regulatory powers that have regard to directors' compliance with their duties.

This means that shareholders or third parties will normally only have a cause of action against the company, not against individual directors. It is quite rare for companies to sue their directors for breach of duty. If directors act in a way that creates a personal obligation – for example an express representation by a director accepting a personal obligation to a shareholder or third party – that director may incur liability direct to the shareholder or third party, but this would also be an unusual situation.

This duty to the company applies to all of the duties of directors under the *Companies Act 2006*, including S172.

Directors hold a position of trust and must act in good faith and avoid self-serving behaviour in carrying out their fiduciary duties. They must abide by the requirements of the articles of association. It is therefore vital that all directors have access to, and are familiar with, the articles.

If a power is given to directors for one purpose, then they cannot exercise it for a different purpose, even if they consider that to do so would promote the success of the company. Directors should act in good faith and exercise independent judgment. It will thus usually be a breach of duty for a director to act in accordance with the instructions of some other person, as that is not the exercise of independent judgment. It is not uncommon in joint venture situations or private equity investments for a person to be appointed to the board as the nominee of some other person. A director is allowed to look after the interests of an appointor, but only in so far as that is compatible with the interests of the company. If all shareholders give an instruction to the director, then the position may be different. However, this is only if the company is solvent and therefore creditors' interests do not take priority.

> *Directors hold a position of trust and must act in good faith and avoid self-serving behaviour in carrying out their fiduciary duties*

Standards of skill and care

Under Section 174 of the *Companies Act 2006*, a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with both:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (the 'objective' test)
- The general knowledge, skill and experience that the director actually has (the 'subjective' test).

What this means in practice is that, at a minimum, a director must display the knowledge, skill and experience set out in the objective test. Where a director has any special skills or experience, they must use them to meet the higher subjective standard. In applying the test, regard will be had to the particular director's functions, including any specific responsibilities held and the company's circumstances.

continues >

Standards of skill and care *continued*

By way of illustration, if a company were to appoint an unqualified person as its finance director, that director will be expected to exercise the skill of a reasonable finance director and will not be excused any lack of skill because they are unqualified. Where a director has a professional qualification, the standard expected of that director will be higher than that required of a person without that qualification.

Directors are not expected to be experts on everything, but where they do have expertise, they should use it. In performing their role, directors can delegate to others, but will remain responsible for the work delegated. They can also – and should, particularly if the company is in financial difficulty – seek external advice where necessary.

Directors should not act outside their powers. Major contracts and commitments need to be properly authorised, whether by board or sub-committee resolution or within delegated authority limits. A director who exceeds his or her powers (e.g. by signing a contract that is not properly authorised) may incur personal liability for the performance of the company's obligations under that contract. The board may subsequently ratify the director's actions and relieve them from personal liability. However, conduct that amounts to breach of duty, negligence or breach of trust can only be ratified by shareholders.

A word of caution: an exception to the rules around directors' duties arises where a company is near to or, in fact, insolvent. In that case, directors must consider the interests of creditors instead of shareholders.

Practical tip: Insolvency

It is incumbent on a director to be aware of their company's financial position at all times. Not all directors are qualified accountants, but hopefully most will be financially literate enough to know when to ask questions of their colleagues or professional advisers. Any sense that the company is struggling to pay its bills as they fall due, or that the company's liabilities may exceed the total value of its assets, should set alarm bells ringing.

Ignorance of an insolvent situation will carry little weight as a defence to a charge of wrongful trading. Failing to realise that a company is in financial difficulties may be regarded as negligent or as proof of unfit conduct by directors, both of which are serious allegations.

If a company is approaching the 'zone of insolvency' and directors are feeling the pressure of circumstances increasingly outside their control, they may be tempted to stand down in the hope of distancing themselves from the company while they can. Although a director's aim might be to avoid claims and preserve their own reputation, this almost invariably has the opposite effect. A director will likely find themselves in a stronger position by remaining on the board and stepping up the frequency of board meetings, as well as reflecting in the minutes the responsible, urgent and well-advised actions being taken by the board and by management.

The board may need to decide to cease trading if the company has reached an insolvent position, thereby minimising the risk of wrongful trading. By remaining on the board, a director may be able to mitigate the issues (which may involve administrative proceedings) and protect the company for the benefit of whichever constituency is by then foremost in the rankings – i.e. creditors if the company is insolvent or shareholders if not.

Key points to consider:

- Have the directors read and understood the articles of association of the company?
- If directors are starting to have doubts about the financial viability of the company, are the board taking the right external advice? Are they clearly documenting the actions being taken to consider the interests of creditors and the basis for ongoing trading?

Q8. I had understood that, as long as we make money for our shareholders, we couldn't be criticised. Is that no longer the case?

Investors and asset managers are increasingly emphasising the importance of wider societal factors for long-term sustainable growth. They are calling for more transparency around how companies manage the factors listed in S172 in order to demonstrate that they are creating long-term value. [30] Directors should feel that S172 protects them from shareholder pressure to achieve short-term gain at the expense of long-term progress.

Making money for shareholders – in the form of dividends – is clearly going to appeal to most investors, but this should not be the case if short-term gains are at the expense of long-term sustainability or the company's very survival.

> *Investors and asset managers are increasingly emphasising the importance of wider societal factors*

[30] For example see BlackRock's 2019 *Letter to CEOs* at www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter and CECP's *Investor Letter* at www.cecp.co/cecp-investor-letter

Carillion's focus on dividends

As part of its investigation into the collapse of Carillion in 2018, Standard Life Aberdeen, a Carillion investor, told the UK Parliament Work and Pensions Committee that, while *"the dividend payment is an important part of the return to shareholders from the earnings"*, it was not in the investor's interests to encourage the payment of *"unsustainable dividends"*.

In December 2015, Standard Life Investments (as it then was) took the decision to begin divesting from Carillion. This was, in part, because the investment company realised that Carillion's insistence on high dividends meant that it was neglecting rising debt levels.

Murdo Murchison, Chief Executive of Kiltearn Partners, another active investor in the company, said that a factor in his company choosing to divest Carillion shares was dividend payments that were *"not sustainable"*:

> *"In our analysis we baked in a dividend cut. When the market is telling you a dividend is not sustainable the market is usually right and, again, it is quite interesting in this context as to why the management were so optimistic about the business they were prepared to take a different view."*

Key points to consider:

- Are the board properly balancing short-term pressures (such as maintaining the dividend) against the longer-term impact on the future success of the company?
- How can the board best explain a decision that they believe is in the long-term best interests of the company, but has a short-term impact on certain stakeholder groups?
- Are the board really confident enough about the future to make the longer-term commitments to stakeholders that are being sought (for example, in relation to maintaining dividend policy or avoiding job losses or factory closures)?

Q9. What if we get it wrong?

Directors' decisions may become more easily reviewable, and are often judged, with the benefit of hindsight. Investors will be better able to hold directors to account and fulfil their stewardship duties once they have information on how directors are fulfilling their S172 duties. This is one of the stated benefits that the Government hopes to achieve. But the new disclosure requirement is not intended to be a stick with which to beat directors. On the contrary, it is hoped that a wider awareness of the S172 duties will provide greater confidence to investors, employees and others dealing with the company. They will be able to see how boardroom decisions are being taken with regard to wider stakeholder interests.

Courts have traditionally been reluctant to interfere with business decisions made by directors. They acknowledge that directors are in control of an entrepreneurial venture and that a degree of risk-taking is a necessary part of earning a sufficient return on the capital invested. While this does not mean that directors' decisions are immune to challenge, mere errors of judgment by directors will not give rise to liability.

During the Lords Grand Committee debate on the *Company Law Reform Bill* in 2006, Lord Goldsmith cites the judgment of Lord Greene MR on UK company law case Re Smith and Fawcett Ltd: *"They must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose".* [31]

Research has suggested that the focus of the English courts is far more on the process by which the business judgment was reached than the judgment itself. [32] Courts have scrutinised board decisions with a view to establishing (1) whether the directors have taken appropriate steps to inform themselves of the relevant facts; (2) whether they have sought appropriate expert advice if necessary; (3) whether they were entitled to rely on any such advice and (4) whether they acted responsibly.

The Business Judgment Rule

The *Business Judgment Rule* is a case-law derived doctrine in company law that courts will defer to the business judgment of a company's directors. It is a mechanism to address risk aversion. The rule exists in some form in most common law countries including the USA, Canada, Australia and, to an extent, England and Wales.

Unless tainted by some self-interest or conflict of interest – and provided the judgment was not one that no reasonable board of directors would have made – the English courts have traditionally shown a reluctance to overturn the business judgment of directors. However, there is no express business judgment defence as such in the UK. Instead, UK courts are prepared to grant directors a margin of error. The court can grant relief to directors for liability if satisfied that the director acted honestly and reasonably and that, having regard to all the circumstances, the director ought fairly to be excused.

This reinforces the need for directors to ensure that the workings of their board and the process of decision-making will bear scrutiny.

D&O liability insurance

Directors face personal liability in certain circumstances despite a company's limited liability status, so a director should ensure that the company takes out adequate directors' and officers' liability (D&O) insurance. This will cover a director's potential exposure in connection with any negligence; default; breach of duty or breach of trust by him or her in relation to the company.

[31] Lord Goldsmith (6 February 2006) Lords Grand Committee, column 254 referring to Lord Greene MR, Re Smith and Fawcett Ltd [1942] Ch 304

[32] University of Leeds School of Law and University of Liverpool Management School (2018) *Business Judgment and the Courts: end of project report*

Key points to consider:

- Is the rationale for the board's decision properly and fully reflected in the minutes?
- Were the board offered options or just a simple recommendation? Were the reasons why alternative choices had been discounted properly explained and recorded in the papers or the minutes?
- Were the right people in the room for this item? Were there stakeholders that the board should have heard from directly?
- Did the directors seek any external advice that was needed? Was that advice clear and unambiguous? Did the board have the opportunity to challenge the company's advisers directly? Should the board have taken its own separate legal advice?
- If there was dissent and disagreement among board members, is that reflected in the minutes and do the minutes help explain how and why the final decision was reached?
- Are individual directors clear on the nature of any indemnity that they have under the articles of association and any separate deed?
- Do individual directors understand the terms and limits of the D&O insurance purchased by the company on their behalf? (The company's brokers should be able to provide a helpful summary of the cover.)

Q10. What should I do if I have a personal interest in the decision?

Directors will have to consider how they perform their duties in relation to their personal conduct. The *Companies Act 2006* made a number of changes to the way in which directors should act. Section 176 sets out a duty not to accept benefits from third parties. Most companies have introduced policies on personal gifts to directors and offers of corporate hospitality from suppliers or service providers, professional advisers, etc. Complete transparency is required. If in doubt, discuss with the company secretary and disclose to the board.

There is also a positive duty to avoid unauthorised conflicts of interest. Recognising and dealing with conflicts of interest is vital to effective governance and decision-making. Demonstrating that a director has done so is a key element of accountability and transparency.

“ *Recognising and dealing with conflicts of interest is vital to effective governance and decision-making*

Section 175 identifies the duty to avoid conflicts of interest. If a director faces an actual or possible conflict of interest by virtue of their position, they must either obtain authority to act, remove the possibility of the conflict or resign as a director.

Worker directors can play a vital role in ensuring that employee considerations are clearly presented to the board and properly taken into account during board decision-making. However, they must remember that, even if not conflicted, their duty is to the company and not to the company's employees.

Key points to consider:

- Does an individual director's particular interest in the proposal represent a conflict? For example, a director living in a town likely to be affected by a proposed set of redundancies would not be a conflict (and that individual could bring some useful insight to the discussion), whereas a director with a close family member who works for a local supplier to the company would have a conflict of interest and should not take part in that element of the discussion.

Q11 What should I expect to see in the board papers and the minutes of our meetings?

Only the reporting requirements for S172 are new, so there is an argument that little needs to change for the best run companies. However, the additional focus on S172 is an opportunity for all companies to review how boards currently discharge their decision-making and oversight responsibilities under S172. Changes might improve the quality and integrity of board decisions, as well as facilitating effective disclosure under the new reporting regime.

Preparing board papers

The Association of General Counsel and Company Secretaries Working in FTSE 100 Companies (GC100) consider that responsibility for considering relevant factors under S172 can properly be delegated to the members of the management team preparing the paper, as is customary in larger companies. [33] They must, of course, be satisfied that they are delegating the task to the appropriate people. In addition, whatever the content of the briefing, the directors would still have to use their business judgment in considering the relevant proposal.

The GC100 recommends providing training and guidance to managers on writing effective board papers, to ensure that the impact of a proposed decision is *"proportionately, clearly and appropriately explained to directors"*. [34]

Key questions for boards to consider:

- Have the board established clear standards on the form and content of papers and presentations that are brought to the board to ensure that relevant stakeholder considerations are appropriately addressed?
- Where decisions are challenged after the event, have the board looked back at the papers they were given, reflected on their deliberations at the time and reviewed how the minutes stood the test of time? What lessons have been learned?

33 GC100 (2007) *Companies Act (2006): directors' duties*

34 GC100 (2018) *Guidance on Directors' Duties: Section 172 and stakeholder considerations*

Practical tip: Minuting reservations

When reviewing board papers ahead of a meeting, it would be best for directors to keep a separate note with the agenda of any points or questions that they intend to raise at the meeting. During or immediately after the meeting, they can annotate their note with the upshot – was the point accepted, rejected, deferred, etc.? What answers were they given to their questions?

This will better enable directors, when the draft minutes are circulated some weeks later, to check that they accurately reflect the fact that the point or question was raised. If they do not, the director should ask the company secretary to amend them. It is customary for minutes not to include details of the discussions or to identify the questioner, unless there was a particular reason or request to do so. In this case, the director is not seeking the limelight but, if they have expressed reservations (e.g. concerning the adequacy of a provision in the accounts, falling sales or a poor customer satisfaction survey), the minutes have strong evidential weight in demonstrating how the director discharged their duty, should the need ever arise.

Q12. How do we avoid including confidential or commercially sensitive information in our S172 statement?

Companies are not required or expected to reveal confidential or commercially sensitive information in complying with the new reporting requirement. It is perfectly possible and expected to describe, for the benefit of investors and wider stakeholders, the manner in which the directors approach their duties. According to *The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013: "Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company."* [35]

Directors should think carefully about the wording used in an S172 statement and ensure that it is not a standard 'boilerplate' statement. Instead, this is an opportunity for directors to demonstrate that they understand their duties – an approach that is more likely to gain the confidence and trust of society.

Key points to consider:

- Does the S172 statement feel like an authentic description of how the board operates?
- Stepping back, is the description distinctive enough? Does it describe how decisions are made in this company or does it read more like a generic description of good practice? Would the statement encourage a prospective employee to come to work for the company?

[35] See section 414C (14) of *The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013*

What Does Good Decision-Making Look Like?

Effective boardroom decision-making is the essence of good governance and the IBE believes that ethical values should be central to a board's decision-making process.

Many companies recognise values and purpose – along with ethical business conduct, sustainability and social responsibility – as characterising the right way to run a business and essential for long-term success.[36] Boardroom ethics, and the way the board behaves and takes collective decisions, is important in underlining how the rest of the business will operate – it sets the tone.

All boards will be faced with very complex matters to decide, some more often and/or more difficult than others. These decisions may involve large numbers of employees or the interests of other stakeholders. Making ethical decisions can be challenging, given the range of pressures that boards encounter.

“ Making ethical decisions can be challenging, given the range of pressures that boards encounter

How companies make good decisions

In 2009, a global survey by McKinsey & Company looked at corporate decision-making processes and how companies can make good decisions.[37] Two interesting findings from the survey are that:

- Decisions initiated and approved by the same person generate the worst financial results (indicating the value of good discussion)
- There are strong relationships between financial success, clarity about who is responsible for implementation, and the involvement of that individual in the decision-making process.

McKinsey also advocates categorising decision types and organising different processes depending on the category. They suggest that, to encourage productive debate on a big-bet decision that may affect the future of the company (for example a major merger or acquisition) the chair assigns a specific board member to argue the case for and another to argue the case against the potential decision or matter under consideration. A ‘rotating devil's advocate role' can also stimulate and encourage critical thinking.

As a process, the board needs first to identify its stakeholders. These include all the stakeholders of the board, the company and – perhaps, if relevant – the sector in which the company operates. A sector regulator would, for instance, be a stakeholder.

[36] IBE (2013) Occasional Paper 8, *A Review of the Ethical Aspects of Corporate Governance Regulation and Guidance in the EU*

[37] McKinsey & Company (2009) *McKinsey Global Survey Results*

> *Ethical decision-making frameworks help to ensure that directors are taking ethics into account in all boardroom decisions*

The second stage is to identify the information needed to take effective decisions. As highlighted previously, ethical decision-making frameworks and models help to ensure that directors are taking ethics into account in all boardroom decisions.

Asking questions is a good way to encourage deep thought and, in addition, it is important to take time to stop and consider potential decisions holistically. Ethical decision-making frameworks are particularly helpful for boards faced with ethical dilemmas, where there are no obvious 'right' or 'wrong' answers.

There are many options for boards to consider when designing an ethical decision-making framework. For example, the IBE's own decision-making guidance is based on transparency, effect and fairness.

The IBE ethical decision-making framework

In making decisions, the IBE suggests that employees ask themselves these three questions:

- **Transparency** – do I mind others knowing what I have decided?
- **Effect** – who does my decision affect or hurt?
- **Fairness** – would my decision be considered fair by those affected?

The GSK and RBS decision-making frameworks included in the Appendix are other examples of what organisations with a mature approach to ethical decision-making are currently doing.

The IBE recommends that companies design their model to be used throughout the organisation to encourage a consistency in decision-making and to help 'future-proof' decisions that may be judged in years to come. Many companies have introduced ethical decision-making frameworks and have included them in their codes of ethics.
The frameworks include questions such as the following:

- How does this align with our values?
- Do I mind others knowing?
- What if everyone at the company did it?
- Would I be happy if this happened to me?
- Would I be happy explaining this on TV or to a close relative?
- Who would my decision affect (positively and negatively)?
- What would it look like in a few years' time?
- Is it legal?

Note the final point on whether a decision is legal. While some companies ask this first, the IBE recommends that legality is not the first issue that should be addressed. It will be harder to challenge a proposal that does not feel right if it is presented as having been 'signed off' by the Legal department (even if, most likely, the Legal department were only asked to opine on the letter of the law, not whether the proposal sat well with the ethical values of the company).

Ethical dilemmas usually come with ambiguity and uncertainty as to the underlying facts, yet are often also raised in circumstances where media or other external pressures require boards to take swift and decisive action. It is much easier for boards to make good decisions under pressure if ethical values have been embedded at the core of the company's culture.

The chair of the board has a critical role to play in ensuring that the decision-making process is carried out properly. Good meeting discipline should be a given. Once a decision has been made, it should be fully documented and effectively implemented by the company, with commitment and accountability.

There is no place for apathy in the boardroom. Directors must be prepared to challenge the status quo. Decision-making by default is not a proper process and leaves the company vulnerable and its directors – particularly NEDs – open to challenge.

Practical tip: Commitment vs consensus

With a view to building consensus, some chairs may – prior to a formal vote – conduct repeated straw polls, or informal votes, on matters where there is initial disagreement around the boardroom table. This could be perceived as 'railroading', or coercing, directors. In any event, studies have found that an over-reliance on consensus can lead to ineffective decision-making. It is better to achieve commitment instead.

Boards should encourage an ethos of enquiry and healthy debate. Communications from the management team to directors to the effect that 'if no one objects to this proposal by a week on Wednesday I shall assume assent and proceed with whatever I have just outlined…' have no place in the boardroom. This type of approach does not even permit – let alone facilitate – discussion or constructive challenge of the executives. It will never, therefore, be a sound approach to discharging fiduciary duties. Equally, directors who participate in decisions without understanding the consequences will be in breach of their duty.

> "*Boards should encourage an ethos of enquiry and healthy debate*

Further, directors need to make themselves aware of the full range of their obligations under the *Companies Act 2006* and have confidence that their fellow directors have a similar level of awareness. Proper training and a good understanding of legal obligations will assist directors in their decision-making. Mentoring, peer review or other less formal processes may also be useful to ensure that the quality of individual decision-making is as good as that of collective decision-making.

GC100 advice on how to embed S172 in decision-making

Advice from the GC100's *Guidance on Directors' Duties* highlights five specific areas of focus followed by an overarching theme of culture, as follows:

- **Strategy:** reflect the S172 duty when you set up and update your company's strategy
- **Training:** establish and attend training courses on induction to the board, with ongoing updates on the S172 duty in the context of your wider duties and responsibilities
- **Information:** consider, and arrange to receive, the information you need on appointment and going forward to help you carry out your role and satisfy the duty
- **Policies and process:** put in place policies and processes appropriate to support your company's operating strategy and to support its goals in the light of the S172 duty
- **Engagement:** consider what should be the company's approach to engagement with employees and other stakeholders for your company, whether through board engagement or wider corporate engagement
- **Culture:** as the board seeks to determine or discuss the culture of your company, consider how you propose to embed in the habits and behaviours of board, management and employees a culture which, in its pursuit of success for the benefit of shareholders as a whole, is consistent with the company's goals in relation to stakeholders, whether employees, customers, suppliers, local communities, the environment or others affected by or engaging with the company's activities. [38]

Companies need to ensure (and directors should insist) that all directors are, prior to making any decision, provided with adequate information about the consequences of that decision. Large private companies and quoted companies of any size should have the resources available to them – within the company or through external specialists – to provide the necessary analysis and reports. Importantly, the duty to have regard to the matters set out in S172(1)(a) - (f) remains the same regardless of the size of a company or the availability of resources. Beware of information overload, though, lest directors become unable to see the wood for the trees.

Lastly, directors must also be aware that when the company is insolvent or there is the threat of insolvency, they must put the interests of the company's creditors before those of its members.

> *Beware of information overload, lest directors become unable to see the wood for the trees*

[38] GC100 (2018) *Guidance on Directors' Duties: Section 172 and stakeholder considerations*

Conclusion

Company law around directors' duties continues to evolve. The law was changed to make it clear that directors can take account of employees, suppliers, customers, other stakeholders and the environment and not breach their fiduciary duties by doing so. This, effectively, puts in place the concept of enlightened shareholder value.

> *Sound businesses are important contributors to a healthy, thriving society and companies enjoy the privilege of limited liability as a result*

Sound businesses are important contributors to a healthy, thriving society and companies enjoy the privilege of limited liability as a result. But it is a privilege, and privileges can be lost.

For over a decade now, directors of English companies have had a legal responsibility to have regard to their company's wider impact. Most large successful companies have fostered a working environment in which the wider responsibilities of the company are accepted and fulfilled. However, recent high-profile corporate failures have contributed to a loss of trust in business. The UK Government hopes that the introduction of the new S172 reporting obligation will help to restore this trust.

Directors also have ethical responsibilities. These include the general acknowledgement that shareholders and other stakeholders have a legitimate interest in how the company is meeting its social and environmental obligations. It is hoped that the new S172 reporting obligation will assist boards in ensuring that, not only do their directors comply with their statutory duties, but also that shareholder, employee and other stakeholder considerations are properly considered in the board's deliberations.

Shareholders do, of course, have the right to vote on who sits on the board and other strategic decisions. However, as was recognised in relation to Carillion's sudden failure, shareholders are often ill-equipped to influence board decision-making. For shareholders in quoted companies, voting with their feet by selling their shares is often the only real option.

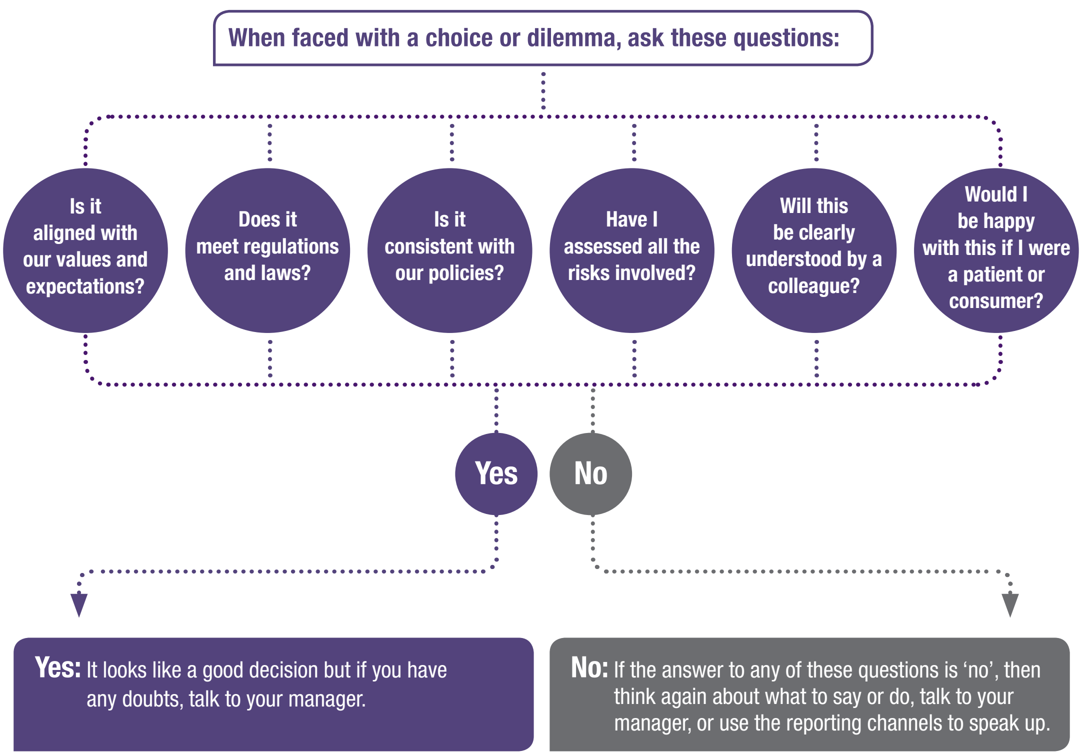
Responsible company directors act in good faith to make decisions that they consider to be in the best interests of the long-term durability of their businesses. They recognise that what is good for business is also good for shareholders and wider stakeholders. The new reporting obligation under S172 of the *Companies Act 2006* represents an opportunity for directors to demonstrate their informed decision-making processes to internal and external audiences.

Appendix 1
Frameworks for Good Decision-Making

As discussed in Chapter 4, ethical decision-making frameworks help to ensure that directors are taking ethics into account in all boardroom decisions.

The following GSK and RBS frameworks are aimed at all employees, but may be particularly helpful to board directors faced with difficult ethical dilemmas.

The GSK decision-making model



Source: GSK (as available in January 2020), *Living Our Values and Expectations: Our Code of Conduct*

The RBS YES check

Our customers, colleagues and the communities in which we do business trust each of us to be thoughtful and professional in everything we do.

They expect each of us to exercise good judgement and to do the right thing.

We use our values to help think through decisions and make sure we do the right thing. When in doubt, we use the YES check for guidance.

Decisions are not always straightforward. The YES check can help us. It's a tool, not a rule.

Ask yourself:

1. **Does what I am doing keep our customers and the bank safe and secure?**
   Consider the impact of what you are doing. Rehearse a briefing with your boss.

2. **Would customers and colleagues say I am acting with integrity?**
   Consider: would I do this to someone in my family or a friend? Would I do it to myself?

3. **Am I happy with how this would be perceived on the outside?**
   Consider the impact of this in the outside world. Try writing the press release – does it sound good for customers?

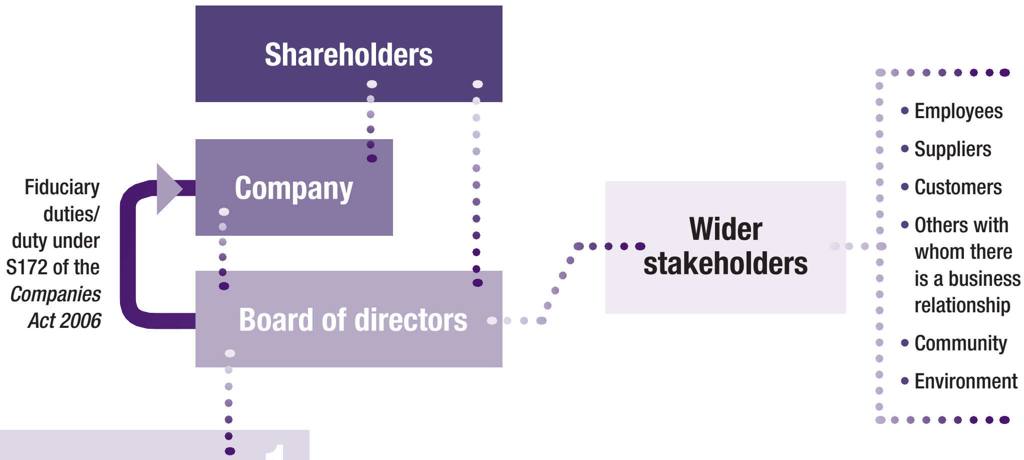
4. **Is what I am doing meeting the standards of conduct required?**
   Think. If you are unsure then seek a second opinion.

5. **In 5 years' time would others see this as a good way to work?**
   Will this have a positive impact? Imagine writing it on your CV.

Source: RBS (as available in January 2020) *This is Our Code*

On the following page is a suggested flowchart for addressing S172 considerations in decision-making relating to a transaction.

Deal flow decision-making



1 Executive management team

- Conduct confidential internal feasibility study
- Prepare board briefing paper including recommendation
- Ensure that each of the relevant factors including those in in S172(1)(a) - (f) are properly considered and include in board briefing paper or board presentation
- Prepare preliminary analysis of stakeholder impact.

2 Board meeting

- Consider and discuss briefing paper from EMT
- Would proposed transaction be consistent with the company's values? Is it ethical? Any reputational risk?
- In what ways does it promote the success of the company?
- What alternatives have been considered? Pros v cons
- Consider stakeholder impact analysis
- Apply own business judgment.

3 Appoint board sub-committee

Why?

- To better maintain confidentiality
- Greater efficiency of smaller group
- Bring specialist board skills to the fore
- More nimble
- Enables more in-depth review (quorum to include one or more NEDs)
- To make a recommendation to the full board.

Set terms of reference/delegated authorities.

4 Executive management team

- Engage advisers
- Progress transaction
- Report to board sub-committee as required
- Update/revise stakeholder impact analysis and any changes to relevant factors/S172(1)(a) - (f) in light of final terms
- Prepare board briefing papers and/or presentation, including identity and solvency of buyer; price and other material terms; actual/contingent liabilities and recommendation from board sub-committee.

5 Board meeting

- Consider briefing paper/ presentation and recommendation
- Test alignment of proposed transaction with the company's values
- Consider stakeholder impact analysis and likely long-term consequences of the proposed transaction
- Raise questions of board sub-committee members and EMT; challenge assumptions
- Apply own business judgment
- Make decision, authorise signatories
- Authorise regulatory and press announcements.

6 Company secretarial tasks

- Record any interests of directors disclosed to the board on register of interests
- Prepare board minutes
- Reflect accurately points raised in the meeting
- Record decisions reached
- Deal with any necessary filings on timely basis.

Appendix 2
List of Additional Sources

Lucy Fergusson and Judy Pink, Linklaters LLP (*Practical Law PLC,* November 2014) *Corporate governance: learning lessons from the past and looking to the future*

Lucy Fergusson and Wilma Rix, Linklaters LLP (*Practical Law PLC*, September 2018) *Corporate governance reforms: widening responsibilities*

Andrew Keay, Professor of Corporate and Commercial Law, Centre for Business Law and Practice, School of Law, University of Leeds (*Sydney Law Review*, Vol 29:577, 2007) *Tackling the issue of the corporate objective: an analysis of the United Kingdom's 'enlightened shareholder value approach'*

Mark S. Schwartz, Thomas W. Dunfee, Michael J. Kline (*Journal of Business Ethics*, 58: 79-100, 2005) *Tone at the top: an ethics code for directors?*

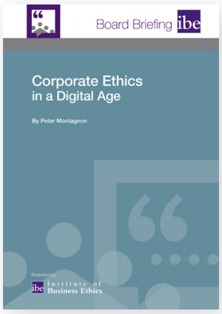
Paddy Ireland, Kent Law School (*Cambridge Journal of Economics*, Volume 34 issue 5, September 2010, pages 837-856) *Limited liability, shareholder rights and the problem of corporate irresponsibility*

Competition and Markets Authority (2011) *Company Directors and Competition Law* OFT1340 [now withdrawn and replaced by Competition and Markets Authority (2019) *Guidance on Competition Disqualification Orders* CMA102]

David Chivers QC for the Corporate Responsibility CORE Coalition (2007) *The Companies Act 2006: directors' duties guidance*

Related IBE Publications

IBE publications provide thought leadership and practical guidance to those involved in developing and promoting business ethics, including senior business people, corporate governance professionals and ethics and compliance practitioners. Some recent publications related to this topic which you might be interested in include:



Corporate Ethics in a Digital Age

Peter Montagnon

Managing the consequences of AI is a major challenge from which boards and corporate leadership cannot abstain. Boards not only have to manage a new set of risks and opportunities – they do so in a world that is rapidly changing in ways that make it harder for them to exercise control. The decisions that boards must take will fit into their general view of risk appetite, risk management and oversight.

Corporate Ethics in a Digital Age offers practical thoughts about how the challenges of AI can be addressed and looks at the expertise that is required in the boardroom. These challenges are less about the technology itself than how it is applied, requiring a philosophical and ethical approach to resolving the dilemmas which AI provokes.

Culture Indicators: understanding corporate behaviour

Peter Montagnon

Boards are increasingly focused on corporate culture, yet they often struggle to understand the forces that drive behaviour in their business. Culture cannot easily be measured, but boards can and do have access to a range of information that will shed light on the culture of their organisations.

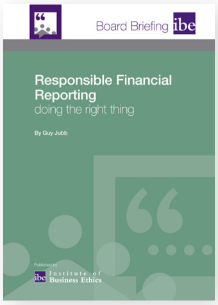
Culture Indicators: understanding corporate behaviour analyses survey data and draws on interviews with directors and those who advise them to provide practical and tangible assistance for boards in how to understand the corporate culture of their organisations. It examines a wide range of relevant indicators and how to interpret them in order to produce a useful and authentic picture of the culture of a business.

Stakeholder Engagement: values, business culture & society

Peter Montagnon

Companies do not exist in isolation. They depend on society for their franchise. So they need to maintain relationships of trust with a wide range of stakeholders. In order to foster trust, external engagement should always be driven by ethical values.

Stakeholder Engagement: values, business culture & society report forms the IBE's contribution to the Financial Reporting Council's Culture coalition in 2016.



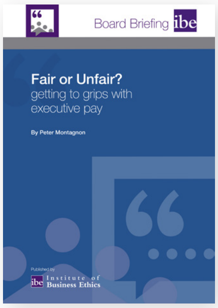
Responsible Financial Reporting: doing the right thing

Guy Jubb

Responsible financial reporting lies at the heart of responsible capitalism and, in today's world, it is more than ever up to directors and, in particular, independent non-executive directors to ensure they do the right thing as a board when it comes to making choices about how to present profits and other key financial data.

Yet this is more than just a question of conforming to the rules laid down by standard setters. Most accounting involves judgment and all judgment contains an ethical dimension.

In this Board Briefing, Guy Jubb, who has spent several decades looking at company accounts from the perspective of an investor, examines the challenges and pitfalls and presents the elements of responsible financial reporting.

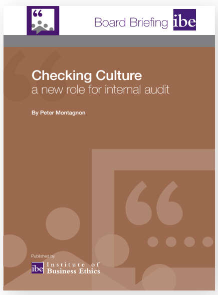


Fair or Unfair? getting to grips with executive pay

Peter Montagnon

Executive remuneration plays an important part in establishing an ethical culture, but it is also very complex and hard for boards to manage. There is a widespread view that the present system in the UK does not deliver the right incentives, and may even be fundamentally broken. In IBE surveys it consistently ranks as one of the top issues the public think business needs to address.

Fair or Unfair? getting to grips with executive pay offers both practical advice on how remuneration committees can address the challenge and some pointers to possible reform centred around the need to be clear about the value of what is being awarded and the pace at which remuneration is earned.

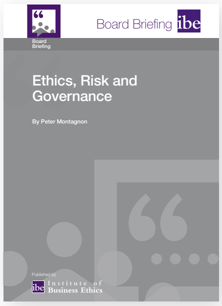


Checking Culture: a new role for internal audit

Peter Montagnon

This IBE Board Briefing sets out the role of internal audit in advising boards on whether a company is living up to its ethical values. *Checking Culture: a new role for internal audit* draws on the experience of those actually involved at a senior level in six companies representing a wide range of sectors and sizes.

Audit experts from Barclays, Aberdeen Asset Management, Airbus, Tate and Lyle, NEC and John Lewis Partnership recount in their own words how they have approached the challenge of checking culture.



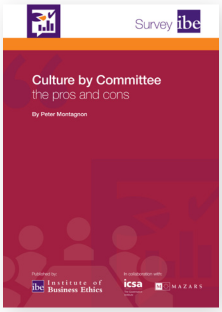
Ethics, Risk and Governance

Peter Montagnon

Setting the right values and culture is integral to a company's success and its ability to generate value over the longer term. The challenge for business is how to develop and embed real values. This requires leadership and is a core task for boards.

Many boards acknowledge the importance of a healthy corporate culture, both because of the role this plays in mitigating risk and because of the value to their franchise of a sound reputation.

This Board Briefing sets out why directors need to be actively involved in setting and maintaining a company's ethical values and suggests some ways to approach it. It aims to help directors define their contribution to the maintenance of sound values and culture.



Culture by Committee: the pros and cons

Peter Montagnon

Shifting perceptions of risk have increasingly encouraged companies to form special board committees to deal with broad questions of corporate responsibility, sustainability and ethics.

This IBE Survey Report looks at the nature and role of these board committees, and also at the way companies that choose not to have such committees handle this growing range of non-financial risks.

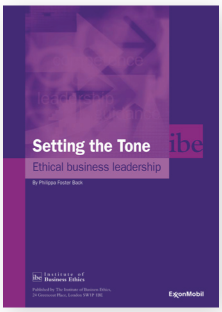
It is based on research into companies in the FTSE 350, including the mandates of the board committees, and was prepared in collaboration with ICSA: The Governance Institute and Mazars.

Ethical Challenges Facing Pension Fund Trustees

Peter Montagnon

This report looks at twelve key questions which pension fund trustees need to ask to help guide them in making sound decisions.

It looks at the ethical challenges facing pension fund trustees - ranging from fiduciary duty, investment decisions and conflicts of interest to employing consultants. It offers answers that, by applying an ethical approach, aim to cut through the uncertainty and help trustees make the right decisions.



Setting the Tone: ethical business leadership

Philippa Foster Back CBE

Leadership is essential to business ethics, as ethical qualities are essential to good leadership. This report demonstrates that business leaders should consider ethical competence as a core part of their business acumen and provides guidance to those wishing to build a culture of trust and accountability, and strengthen the ethical aspirations of their organisation. It includes interviews with business leaders offering practical insights into ethical leadership issues.

Other IBE Resources

The IBE Speak Up Toolkit

The freedom to raise concerns is a core component of a supportive ethical culture where employees are confident they will be supported to 'do the right thing'.

Yet, despite increasing encouragement from organisations, employees still remain reticent. Speaking up can be an experience that provokes a mix of emotions; it may feel complex and daunting.

This is why the IBE has developed *The IBE Speak Up Toolkit*, to empower employees by demystifying the process and managing expectations.

The IBE Speak Up Toolkit helps employees prepare for raising a concern at work. It answers any questions you may have about the process – from noticing a problem and having a conversation through to what to expect if you call a Speak Up helpline or if your concern is investigated.

The IBE Speak Up Toolkit can be accessed free of charge or can be tailored for organisations wishing to link to their own policies and resources.

www.ibe.org.uk/speakuptoolkit

The IBE Say No Toolkit

The IBE Say No Toolkit is a decision-making tool to help organisations encourage employees to make the right decision in difficult situations. *The IBE Say No Toolkit* delivers immediate guidance to employees on a wide range of common business issues, especially those that could lead to accusations of bribery.

Employees tap through a series of questions about the situation they face and the tool will provide the right decision to take: Say No, Say Yes or Ask. The answer also makes it clear why it is important to make that decision so your employees can have the confidence and the knowledge to respond correctly.

Organisations can use both *The IBE Say No Toolkit* app and website for free. The app can be downloaded on to any smartphone or tablet.

Simply go to www.saynotoolkit.net

The IBE Say No Toolkit can be customised and branded to suit your organisation's needs and detailed procedures. For more information email info@ibe.org.uk or call the IBE office on +44 20 7798 6040.

For details of all IBE publications and resources visit our website www.ibe.org.uk

Ethics and Section 172
key questions for informed board decision-making

IBE Board Briefings aim to support board members and those who advise them by drawing their attention to and suggesting ways to approach particular ethical issues.

The introduction of Section 172 of the *Companies Act 2006* (S172) provided boards with a clearer framework for decision-making. A string of corporate failures have now led the UK Government to require boards of large companies to report on how they have discharged duty under S172 and, in particular, how they have had regard to their broader stakeholder community in their board decision-making.

The aim of this Board Briefing is to help companies benefit from the new reporting obligation, and to encourage them to go beyond legal requirements. It provides practical guidance for boards around making decisions as a group, answers key questions and highlights issues for individual directors to consider.

It will help boards navigate through their own decision-making, giving consideration to ethical values in a way that will lead to meaningful reporting to stakeholders in the new S172 statement.

Institute of Business Ethics

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