



Regenerative Business Working Group

Amending UK Company Law for a Regenerative Economy

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Introduction



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We face several global emergencies including the threat of serious and permanent changes to our climate and physical environment and growing levels of inequality. They are interconnected with climate justice as a critical element of the wider crises.

A broad coalition of actors including scientists, economists, politicians, entrepreneurs and activists, are calling for a fast and fundamental reset of our political and economic systems to avert these risks.¹ The challenge they identify is to ensure that these systems contribute not to degradation and destruction, but to creating a safe and just operating space for humanity; or, as economist Kate Raworth prefers to put it, to “get into the doughnut.”²

Depicted as a ring or “doughnut”, the outer edge of the space where humanity can operate safely and sustainably is drawn by our planetary boundaries. Continuous transgression of those boundaries will, according to current scientific projections, eventually lead to an undermining of our ability to inhabit planet Earth safely.

The inner edge of the ring – the “hole in the doughnut” – is marked by social standards including democratic governance, social rights and justice. These provide a floor, moving below which would threaten stability and peace in our societies.³

These emergencies, then, present us with a concrete task, namely, to accelerate the transition to a *regenerative* economy that stays within a just and safe operating space for humanity, and to look at economic structures ‘through the lens of ecology as if both people and planet mattered equally’.⁴

The regenerative framework of economics is supported by a growing number of scientists and economists. It is premised on an understanding of our economy in *system terms*, calling for ‘the application of nature’s laws and patterns of systemic health, self-organization, self-renewal, and regenerative vitality to socioeconomic systems.’⁵ John Fullerton frames it as direct call to action by describing regenerative economics as a system to ‘bring our economic theory and practice into alignment with our latest understanding of how the universe and our humanity actually work!’⁶

Transitioning to such an economy means to guarantee that ‘people become full participants in regenerating Earth’s life-giving cycles so that we thrive within planetary boundaries.’⁷

¹ See Financial Times, ‘Reset Capitalism’ campaign launched in September 2019, https://aboutus.ft.com/press_release/ft-sets-the-agenda-with-new-brand-platform

² K Raworth, *Doughnut economics: seven ways to think like a 21st-century economist* (Random House, 2017)

³ See also J Rockstroem et al., ‘Planetary Boundaries: exploring the safe operating space for humanity’ (2009) 14 *Ecology and Society*; W Steffen et al., ‘Planetary boundaries: guiding human development on a changing planet’ (2015) 347 *Science*; M Leach et al., ‘Between social and planetary boundaries: navigating pathways in the safe and just space for humanity’, *World Social Science Report*, 2013

⁴ A phrase borrowed from the Schumacher College to describe regenerative economics, https://www.schumachercollege.org.uk/courses/postgraduate-courses/ma-regenerative-economics?gclid=EAlalQobChMlyeCWsMnP6glVm-vtCh2scwzDEAAYASAAEgKhYfD_BwE

⁵ The Capital Institute, *Regenerative Economics*, <https://capitalinstitute.org/regenerative-capitalism/>

⁶ J Fullerton, *Regenerative Capitalism: How universal principles and patterns will shape our new economy*, 2015 p. 3, <https://capitalinstitute.org/wp-content/uploads/2015/04/2015-Regenerative-Capitalism-4-20-15-final.pdf>

⁷ K Raworth, *Doughnut economics*, fn. 2 above, p. 133.

Business for a regenerative economy

Business has a key role to play in this process, but business itself is guided by economic as well as social, cultural and legal context.⁸

In this circular movement or feedback loop, companies are both actors and reactors. They can actively set parameters for system change at micro-level, for example by adjusting their operation so that concern for profit and shareholder value does not consistently trump a more fundamental aim of delivering shared prosperity on a thriving planet.⁹

But in the same movement, the company is also where wider economic, social and cultural messages, and legal norms that are set at the macro-level, percolate and take a concrete form. How these norms influence the operation of our businesses today is an important factor to consider.

Acknowledging their interconnectedness, new economic thinking increasingly views business as a participant in holistic economies as ‘complex living systems evolving within dynamically changing complex natural systems’.¹⁰

Changes at the micro-level of the business organisation should not be seen in isolation. To achieve meta-level change (a transition towards regenerative economic operating), interaction at both meso-level (networking and culture change) and macro-level (collaboration for policy and regulatory change) are equally essential.

We see as important these attempts to develop a system view of interconnected levels in the economy, where business is understood to operate in a web of relationships. These integrate micro- and macro-level, but also *meso* and *meta* layers. A key role for business lies in building connections at meso level (transforming culture) to drive meta-level change (recognising the economy as complex and holistic living system).

The following graphic, taken from the B Lab Climate Justice Playbook for Companies, sketches the nature of these interactions in attempts to achieve climate justice in a regenerative economy.¹¹



⁸ N Boeger, R Russell and C Villiers, Companies, Shareholders and Sustainability, November 2020, available as Bristol Law Research Paper 7/2020, <http://www.bristol.ac.uk/media-library/sites/law/documents/Boeger%20Russell%20Villiers%20BLRP%20No.%207%202020%20Companies%20Shareholders%20Sustainability%20-%20MERGED.pdf>

⁹ See the concept of 'sustainable thriving', Earthville Network, <https://earthville.org/resources/sustainable-thriving/>

¹⁰ A Sheng and X Geng, 9 October 20212, The new economics: Meso and Meta, World Economic Forum, <https://www.weforum.org/agenda/2012/10/the-new-economics-meso-and-meta/>

¹¹ B Lab, Climate Justice Playbook for Business, p. 16, <https://pardot.bcorporation.net/climate-justice-playbook-for-business-2021>

Profit with purpose

The purpose of this White Paper is to consider how UK company law might be refined and tailored to enable businesses – in particular, those that incorporate as public or private companies – to accelerate the transition to a regenerative economy.

We refer to businesses that expressly acknowledge this acceleration in their corporate constitution as committed to **‘profit-with-purpose’**.¹²

They continue to operate for the benefit of their members and recognise the importance of their investors’ role in ensuring the firm’s profitability for successful operating. But instead of focusing on the pursuit of profit and shareholder value as their primary or exclusive objective, these profit-with-purpose businesses are committed to generating value by operating for profit and return on investment while at the same time creating positive impact, and avoiding negative impact (by reducing, avoiding or reversing harm), on the environment and the interests of wider society.

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¹² Global Steering Group for Impact Investment, <https://gsgii.org/reports/profit-with-purpose-businesses/>

The role of directors

Profit-with-purpose businesses rely on a network of people committed to sustaining them to make them succeed. This includes investors committed to long term sustainable strategies rather than short term financial returns. They also depend on the active support of consumers, employees, public agencies, media, civil society and others to ensure they can play an active role in the transition to a regenerative economic system.

However, the key to their success, in collaboration with these other stakeholders, arguably rests with the board of directors. Inside the boardroom, the CEO and executive directors will steer day-to-day corporate decision-making and strategy, while non-executive directors fulfil important governance functions mostly without direct involvement in day-to-day strategic decisions.¹³

The opportunity for profit-with-purpose businesses to thrive depends to a large extent on the discretion exercised by directors, including executives and non-executive directors exercising their respective functions, to govern in line with regenerative principles, and to have regard to the company's long-term interest. How they exercise such discretion is shaped by commercial and cultural as well as legal factors.

Our focus in this White Paper lies with the law on directors' duties in the current UK company legal framework. We concentrate on the company legal form, and especially on larger private and public limited companies - bearing in mind, however, that the substantive choices facing business leaders will often be similar, regardless of the business form (for example, in partnerships).

Is the law a reliable guide in helping directors steer the difficult decisions, where the demands of satisfying short-term financial expectations (which are often incentivised) stand in conflict with the principles and practice of a regenerative distributive economy?

We ask whether the current company law offers adequate support to help directors be the business leaders we need to transition companies to a regenerative economic system.

The opportunity for profit-with-purpose businesses to thrive depends to a large extent on the discretion exercised by their directors to govern in line with regenerative economic principles, and to have regard to the company's long-term interest.



¹³ UK Financial Reporting Council, Guidance on Boardroom Effectiveness, 2018, <https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF>; UK Higgs Review of the role and effectiveness of non-executive directors, 2003, <https://webarchive.nationalarchives.gov.uk/20121106105616/http://www.bis.gov.uk/files/file23012.pdf>

Our approach

We structure our Paper in three parts. Our starting point in **Part One (What will be your legacy?)** is the perspective of the executive company director who may wish to accelerate the transition to a profit-with-purpose business format, while facing complex questions about what currently is legally and commercially possible to pursue this. Insofar as these questions concern the interaction with company law, they raise two distinct sets of issues:

- First, at the company level, directors will be looking for advice on suitable legal drafting and a step-by-step process to incorporate this “upgrade” into their company’s constitutional documents, enabling an effective transition to profit-with-purpose by choice.
- Secondly, as these voluntary choices become more popular among companies, it is not unreasonable to consider the case for introducing mandatory changes to UK company law that make profit-with-purpose a default for all companies, as a matter of law.

We discuss these two sets of issues separately, in Parts Two and Three of the Paper.

Part Two (Walking the Talk) offers support for voluntary company-level action to transition to profit-with-purpose, by taking steps that are widely possible today within existing UK company law.

They involve persuading boardrooms and shareholders to “walk the talk” of profit-with-purpose and to make required changes to constitutional documents. It typically means incorporating a purpose clause to steer the business beyond the pursuit of shareholder value, leaving directors with discretion to apply profit-with-purpose principles in their decision-making.

We provide a step-by-step outline to making these legal changes, based on the legal test required for certification as a B Corporation in the UK, in recognition of a commitment to profit-with-purpose.¹⁴

But our ambition cannot stop here. Encouraging individual businesses to take action as a matter of choice is an important step but, as we set out in **Part Three (Legal Reform)**, it cannot ultimately replace a campaign for change in the law itself to ensure a transition to profit-with-purpose for all companies: a legal reform that brings the UK company law on directors’ duties expressly in line with the principles of a regenerative economy.

This part of the Paper concludes with an outline of key changes proposed to the legal framework in section 172 of the UK Companies Act 2006, that would revise the law on company directors’ duties, including reporting requirements, to ensure that directors will, without exception, lead firms towards a regenerative and sustainable economic system.

I would like to thank everyone who contributed to this White Paper, and in particular my co-author Charmain Love.

Nina Boeger

¹⁴ <https://bcorporation.uk/>

Part One: What will be your Legacy?

Many company directors today are concerned about their legacy, and some are ethically invested in doing wider good in society through their commercial leadership: creating welfare in a broader sense than generating profit for shareholders.

They are equally committed to ensuring the commercial success of the company they lead, ideally by creating long-term benefit for shareholders *and* for society. But some are concerned about liabilities, and the question of how much wriggle room the law leaves them to pursue ambitions to generate value beyond short-term financial return.

For the CEO and executive directors, as those involved in day-to-day strategic decision-making in the company they serve, identifying business strategies to enable this is a challenge they confront. Executives in listed companies are often particularly conflicted in taking these decisions, due to the demands that both markets and the law impose on them to align themselves with shareholders, often heavily incentivised in their remuneration package. But many private firms, where shareholders and directors are often one and the same, are inherently conflicted too.

In a concrete scenario, directors of a British public limited company may come to debate a board-level decision which they know will increase climate risk or impose social cost (on, say, the company's workforce or supply chain) or take away resources from another more socially responsible project. But it will create a large short-term return for shareholders.

If the decision goes ahead, some directors at least may feel profoundly uncomfortable - this is not the legacy they want to leave behind. But to what extent is there a choice and are they bound to push ahead? What constraints and considerations, bound-up in corporate strategy, commercial context and legal rules, will guide their decision?

What is our corporate purpose – what do we stand for?

Company directors in the UK, as in most other jurisdictions, are legally bound to protect their company's interests.¹⁵ The law, however, is not prescriptive or conclusive on what it means to act in a company's interests. It does, as we shall see below, prioritise the interest of shareholders, but at the same time leaves directors a wide measure of discretion in the discharge of their duties vis-à-vis the company (to exercise their "business judgment").¹⁶

Clearly, acting in the company's best interest does not have to mean pursuing short-term profit for shareholders¹⁷, but directors will want to know when it is acceptable to prioritise other stakeholders or sustainability and the long-term. Some companies help their directors by setting out their corporate purpose clearly in their articles of association including, where they consider this to be an important interest, a commitment to stakeholders and sustainability.¹⁸

¹⁵ Section 170(1) of the UK Companies Act 2006.

¹⁶ A Keay and J Loughrey, *The Concept of Business Judgment*, (2019) *Legal Studies*, 39 (1), pp. 36-55.

¹⁷ B Sjäfjell, 'Dismantling the Legal Myth of Shareholder Primacy: The Corporation as Sustainable Market Actor' in N Boeger and C Villiers (eds) *Shaping the Corporate Landscape* (Hart, 2018) 77-94.

¹⁸ See also the growing support among Business Schools for guidance on a corporate 'statement of purpose', for example <https://www.sbs.ox.ac.uk/news/oxford-said-urges-corporate-boards-issue-statement-purpose>

Some companies help their directors by setting out their corporate purpose clearly in their articles of association including, where they consider this to be an important interest, a commitment to stakeholders and sustainability.

A statement of purpose alone may not resolve the difficult decisions directors face but, in expressing clearly what the company stands for, it provides a framework within which to justify their choices. Company law acknowledges this scenario by clarifying that, where the business does expressly commit to constitutional purposes beyond promoting the success of the company for the benefit of its members, directors are legally committed to achieving those purposes.¹⁹

What do the shareholders expect?

Not all shareholders think alike on the issue of balancing profit and other business considerations, including the interests of wider society. Because directors are accountable to shareholders, they will want to know what is expected of them, but in a publicly listed (or large private) company serving diverse investment interests, the shareholders' annual general meeting alone often does not serve this purpose.

Even in smaller companies, communication can break down, some shareholders hold more voice than others, and some change their minds more frequently than others. Issues relating to the power dynamics and influence among shareholders, and the need for equal and diverse voices to be heard are widely debated, including among investors communities.²⁰

To provide greater clarity and consistency in directing corporate strategy, companies may choose to incorporate wording beyond a statement of purpose into their constitutional documents (including shareholder agreements, if any), to deliver unequivocal guidance for directors as to how the shareholders collectively expect them to exercise their duty towards the company. To do so requires careful drafting and shareholder approval (see Part Two below).

What does company law require?

Where the constitutional documents provide no or little guidance, directors will have no alternative but to fall back on general company law. In that regard, a central provision in the UK company law on directors' duties is contained in section 172 of the Companies Act 2006, often described as the law on "enlightened" shareholder value.

The provision imposes on directors an obligation to 'promote the success of the company for the benefit of members as a whole' and in doing so to 'have regard to' a range of stakeholder interests including, by implication, sustainability. Specific interests, listed in the law, include the likely consequences of any decision in the long-term, the company's reputation, the interest of employees, relationships with suppliers, customers and others, and the impact of the company's operations on the community and environment.



¹⁹ Section 172(2) Companies Act 2006, set out below.

²⁰ J Litt, 'Why All Shareholder Voices, Even Passive Ones, Matter', New York Times, 20 July 2017, <https://www.nytimes.com/2017/07/20/business/dealbook/why-all-shareholder-voices-even-passive-ones-matter.html>

The full text of section 172 reads:

172 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.

The provision in section 172(1) clarifies that, in the eyes of the law, the interests of the company generally align with those of its shareholders (members).²¹ But it also gives recognition to stakeholders and opens a window to look beyond narrow or short-term financial considerations in the pursuit of shareholder value.

Seen in combination with the “business judgment” rule, which leaves company directors wide discretion to determine corporate strategy, this law places relatively few legal constraints on decisions to support stakeholders and the long-term, provided a director can make the argument that these are likely to produce shareholder returns in the future. It provides flexibility as long as directors can make a business case for prioritising a regenerative vision for their company.²²

But in other ways, section 172(1) fails to support this vision. By insisting on a business case logic, the provision implies all corporate decisions must answer to this test of shareholder value.

In fact, there is evidence to suggest, as we set out in Part Two, that many profit-with-purpose businesses produce better returns in the long term than those run more traditionally for profit. But to run a profit-with-purpose business effectively, directors need flexibility to take some decisions that may prioritise people and planet even when there is *no clear or immediate business case for doing so*.

When faced with these “hard” decisions, unless the company's constitution provides enough room to pursue them, the wording of section 172(1) offers directors little by way of reassurance. Regenerative-minded directors who are concerned about their legacy of profit-with-purpose and hope to find encouragement in the law to enable this, may ultimately be disappointed.

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²¹ A breach of their duty by a director towards the company can be challenged by the company itself (in practice, the other board directors acting on behalf of the company) or by a shareholder in a ‘derivative claim’. See section 260(1) UK Companies Act 2006.

²² A Johnston, ‘Reforming English Company Law to Promote Sustainable Companies’, (2014) European Company Law 11(2) 63-66.

Others have pointed to the relatively open wording in section 172(1) as avoiding a more substantive commitment to protect stakeholders.²³ The provision requires that directors consider - 'have regard to' - the position of different stakeholders across a range of activities, including in agreeing governance structures or settling business plans and budgets.²⁴ But it delivers no unequivocal instruction to follow through on these considerations in ways that clearly take the company beyond a narrow short-term corporate horizon. If challenged, directors will be expected to show what measures were taken to ensure relevant interests are accounted for in strategic decisions. But there is no further-reaching obligation for their decisions to substantially promote these interests.²⁵

Notwithstanding the stakeholder-oriented language of section 172(1), it leaves directors free to focus on short-term financial returns even when the long-term impact of a decision on stakeholders has been considered.²⁶ Some will see this as welcome flexibility to commercially adapt their decisions, but regenerative-minded directors may equally find a stronger steer in the law helpful to resist potential shareholder pressure to act in a short-term manner.²⁷

What can directors do?

Directors may still pursue a commitment to profit-with-purpose within this legal framework, even if it means navigating difficult choices in their strategic decision-making. To facilitate these choices, they may persuade the boardroom and shareholders to "walk the talk" of profit-with-purpose by making changes to the company's articles of association that give directors both flexibility and reassurance.

This, as outlined, involves incorporating legal clauses to replace the language of section 172(1) and its focus on (enlightened) shareholder value, with a regime of corporate decision-making aligned with a profit-with-purpose approach. It typically includes a purpose statement that activates the flexibility for which section 172(2) expressly provides.

²³ Lord Wedderburn of Charlton, 'Employees, Partnership and Company Law' (2002) 31 (2) *Industrial Law Journal* 103.

²⁴ J Palmer et al. (Herbert Smith Freehills), GC100 guidance on section 172: focus on directors' duties, 20 December 2018 <https://www.herbertsmithfreehills.com/latest-thinking/gc100-guidance-on-section-172-focus-on-directors'-duties>

²⁵ See Gore-Browne on Company Law, Part IV, Chapter 15 Directors' Duties, Duty to promote the Success of the Company, available at LEXISNEXIS at https://www.lexisnexis.com/uk/legal/results/enhdocview.do?docLinkInd=true&ersKey=23_T29041421711&format=GNBFULL&startDocNo=0&resultsUrlKey=0_T29041421713&backKey=20_T29041421714&csi=432085&docNo=23&scrollToPosition=2581

²⁶ GC100, GC100 response to the FRC's 'Proposed Revisions to the UK Corporate Governance Code', 28 February 2019, at 3, <https://www.frc.org.uk/getattachment/d841f9c1-ec3c-492b-b4a5-6d2fclea8633/GC100;.aspx>

²⁷ A Keay, 'Risk, shareholder pressure and short-termism in financial institutions: does enlightened shareholder value offer a panacea?' (2011) 5 (6) *Law and Financial Markets Review* 435.

Part Two: Walking the Talk

The number of firms prepared to make the adjustments necessary to operate as a profit-with-purpose business is growing, motivated by a range of factors.

A review initiated by the UK government in 2016 for example identified a rise in “mission-led” businesses in the British economy, including established firms and start-ups.²⁸ The review saw, on the one hand, more public companies ‘move away from the “offset” model with specific resources allocated to corporate social responsibility, to a broader agenda under which social impact is integrated across the business and seen as driver of value’ while, on the other hand, ‘increasing numbers of start-ups are being launched specifically to address a social challenge’.²⁹

Further evidence since then has confirmed that for many firms, a transition to profit-with-purpose has proven *both the right thing and a smart thing to do*.

- *The right thing to do*, as polling of UK consumers carried out for B Lab UK in May 2020 found that 72% of those surveyed believe business should have a legal responsibility to people and the planet, alongside maximising profit. In addition, 76% of the UK public think business should have a legal responsibility to protect the natural environment. The same poll found that businesses acting in this way would also find favour with consumers, with a majority favouring brands that are doing good in the world.³⁰ Other polls also indicate that this is what wider society wants and what is necessary to regain trust in business.³¹

²⁸ UK Government, Mission-Led Business Advisory Panel Report, ‘On a Mission in the UK Economy’, 2016, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/574694/Advisory_Panel_Report_-_Mission-led_Business.pdf

²⁹ ‘On a Mission in the UK Economy’, above fn. 28, p. 9

³⁰ See <https://bcorporation.uk/news/system-upgrade-press-release> <https://ourstory.bcorporation.uk/> and <https://ourstory.bcorporation.uk/>

³¹ Edelman Trust Barometer UK 2020, p. 47-49, <https://www.edelman.co.uk/research/2020-trust-barometer-uk-results>

The purpose of this legal change in the company's constitution is to differentiate the profit-with-purpose business from traditional companies, leaving directors scope for interpretation and discretion in balancing economic, environmental and social factors in their decision-making

- *A smart thing to do* when there is evidence that businesses that 'create economic value by creating societal value' are more resilient and do better than others. The 2016 UK mission-led business review identified 'growth in mission-led business reflects broader changes in society, which shows not only expectations for a bigger role for mission-led businesses, but also that those businesses will be more successful.'³³

According to independent analysis conducted in November 2020, companies run as B Corps in the UK have demonstrated faster growth in turnover and employee headcount, greater levels of employee retention, engagement and diversity, and higher levels of innovation, as measured by applications for R&D tax credits and new goods and services.³⁴

Drive to collective action

These are choices for individual businesses to make, but they should be seen also for their collective strength to drive wider action, as those firms that have indeed walked the talk of profit-with-purpose act as pioneers and come together to drive system level change.

There is emphasis on the need for coalitions to work together, to make change happen as a critical mass of businesses 'committed to move away from the concept of shareholder primacy towards fully addressing sustainability and ensuring that no stakeholders are significantly harmed.'³⁵

These businesses have all given themselves a purpose wider than profit, and shareholders or partners (as relevant) have given a steer as to what they want their leadership to do to operate in accordance with that purpose.

One of the drivers in this movement is the advent of certified B Corporations (B Corps for short) in the UK.³⁶ B Corps are businesses assessed for meeting 'standards of verified social and environmental performance, public transparency and legal accountability.'³⁷

To satisfy the assessment for certification, firms must meet a series of requirements, including a B Corp legal test that includes changes to their constitution.

The legal pathway to becoming a B Corp can be time consuming: it involves step-by-step amendments to the firm's constitutional documents to include the B Corp legal language, reflecting a commitment to a profit-with-purpose approach to business, in an agreed form.³⁸ To date, over 430 firms, including SMEs all the way to multinational corporations, have successfully sought certification since the process has been available in the UK.

To be clear, becoming a profit-with-purpose business is perfectly possible without seeking B Corp certification. But the availability of certification offers profit-with-purpose businesses the advantage of demonstrating their commitment clearly to the outside world.

It clarifies what practical steps are necessary, in legal terms and beyond, for profit-with-purpose businesses to "walk the talk" of their convictions.³⁹ It has also encouraged more targeted research and the collection of detailed data on the operation and impact of profit-with-purpose businesses in the UK.⁴⁰

The following outline is based on the B Corp legal test and related guidance, making reference to the legal format of a UK company limited by shares.

³² M E Porter and M R Kramer, 'Creating Shared Value', (2011) Harvard Business Review, p. 7, available at https://files.transtutors.com/cdn/uploadassignments/2703816_3_shared-value-harvard-business-review.pdf

³³ 'On a Mission in the UK Economy', above fn. 28, p. 11, with further data sources.

³⁴ C Morley and M Goodchild, An independent comparative study into the financial and operational performance of B Corporations in the UK, November 2020, <https://bit.ly/3fGzsjH>

³⁵ Call to Action on Sustainable Corporate Governance, The Modern Corporation, 2021, <https://themoderncorporation.wordpress.com/call-to-action-on-sustainable-corporate-governance/>

³⁶ See D. Hunter, 'The Arrival of B Corps in Britain: Another Milestone Towards a More Nuanced Economy?' in N. Boeger and C. Villiers (eds.), Shaping the Corporate Landscape: corporate reform and enterprise diversity (Hart Publishing, 2018)

³⁷ See <https://ourstory.bcorporation.net/introduction/>

³⁸ See 'The "Legal Requirement" for a B Corp in the UK - An Explanation', dated 17 September 2018, available at <https://bcorporation.net/united-kingdom-yes> via link to document <https://drive.google.com/file/d/1h0iswtPoGeKW3nJqwkYsXBsFKn4aG5/view> and 'B Corporation: Legal pathway' available at <https://blab-mktg-bcorporation-production.s3.amazonaws.com/Guide%20to%20the%20Legal%20Test%20for%20B%20Corps%20in%20the%20UK.pdf>

³⁹ Note also in 42 jurisdictions globally, including Delaware (but not including the UK), the availability of the benefit corporation legal format as a way to meet the test.

⁴⁰ C Morley MBE and M Goodchild, November 2020, An independent comparative study into the financial and operational performance of B Corporations in the UK; M Villela et al., 'B Corp Certification and Its Impact on Organizations Over Time', Journal of Business Ethics (December 2019) 1-15.

Constitutional change

The commitment of a profit-with-purpose business is written into the constitution of the firm, affecting all aspects of its operation. It is far more than a CSR strategy, which typically operates distinct from other aspects of the business. The language representing these commitments will be incorporated, in the case of a limited company, into its articles of association and other relevant constitutional documents. For other legal forms, equivalent adaptations are necessary.

The purpose of this legal change is to differentiate the profit-with-purpose business from a traditional company, leaving directors scope for discretion in balancing economic, environmental and social factors in their decision-making that may go beyond the framework of section 172(1). But careful drafting is advisable to ensure reference is made to the general framework, which has the benefit of being well-understood in the UK.

For example, the suggested wording to be incorporated into the articles of association of B Corps which are incorporated as limited companies in the UK, has been described as “minimalist” and not overly prescriptive. It involves replacing shareholder value with a profit-with-purpose objective, incorporating the commitment to having a material positive impact on society and the environment. But it leaves intact the wording of section 172(1) insofar as it expects directors to have regard to the interests of various stakeholders.

This incorporates a profit-with-purpose approach into the business, activating the flexibility provided for in section 172(2), while allowing the company still to operate within the general framework of section 172.⁴¹

A step-by-step process

Integrating the language of profit-with-purpose into the business constitution requires careful planning and a step-by-step process. The following suggested process is based on the legal pathway that guides B Corps to certification, but it has been adjusted to account more generally for a transition process that businesses wishing to adapt their format will have to address, tailored particularly to those adopting the legal form of a UK company limited by shares.⁴²

1

Board-level review: board members review and agree on the new language of a company purpose. The board considers how the new objective can best be integrated into the existing constitutional documents (including shareholders agreement, if any). Board members should check the existing constitution for restrictions on amendments and any shareholders agreements for consents that may be required, and discuss the process and timetable required for amendments to be made.

2

Stakeholder review: it is beneficial, especially in medium or large companies, to select a senior figure or team inside the firm who will lead the internal transition process. They will be responsible for engaging stakeholders (e.g. board members, shareholders, legal counsel, committees and workforce) in a transparent review of the process, even if this can be time-consuming. They will feed stakeholder input back to the board, allowing sufficient time for stakeholders to express views and ensuring accountability.

3

Board approval: following the review, the board meets to finalise and approve the legal language and resolves to convene a shareholder general meeting or propose a written resolution (step 4).

4

Shareholder resolution: a shareholder special resolution is passed to approve the amendment of the company's articles of association, either by way of written resolution or resolution at general meeting. The statutory notice period for calling a general meeting applies, unless otherwise specified in the articles of association.

5

Filing: the documentation, including the amended articles of association and a copy of the special resolution, is filed with Companies House within applicable time limits.⁴³

⁴¹ The full suggested wording is set out in 'The "Legal Requirement" for a B Corp in the UK - An Explanation', dated 17 September 2018, available at <https://bcorporation.net/united-kingdom-yes-via-link-to-document-https://drive.google.com/file/d/1h0iswtPoGeKW3nJqwketYsXBsFKn4aG5/view>

⁴² See 'B Corporation: Legal pathway' available at <https://blab-mktg-bcorporation-production.s3.amazonaws.com/Guide%20to%20the%20Legal%20Test%20for%20B%20Corps%20in%20the%20UK.pdf>

⁴³ See <https://www.gov.uk/file-changes-to-a-company-with-companies-house>



Part Three: Law Reform

It is possible for any company to become a profit-with-purpose business, but barriers often relate not to legal process but to cultural context and markets.

Large, especially listed, companies can find it particularly difficult to confront these, given their exposure to the pressure and incentives of financial markets.

Given this context, we are sceptical that reliance on voluntary corporate action alone can lead to a place where profit-for-purpose becomes the default option for every business. In addition, a mandatory reform of the law is required.

In this part of the White Paper, we make the case for a legislative revision, by campaigning for a change in the law of section 172 of the Companies Act 2006 to ensure it aligns with the profit-with-purpose approach to business. Given the nature of these proposals, we anticipate some resistance to change. Legal reform is an ambitious political project, but we take inspiration from Sir David Attenborough that when it comes to climate change ‘we cannot be radical enough’.⁴⁴

While widespread voluntary action at company-level to move to a profit-with-purpose business format is welcome, it cannot avoid the issue of legal reform of section 172 Companies Act 2006.

Tightening the belt?

For some time, it has been suggested that a progressive interpretation of the existing wording in section 172, possibly supported by extended soft law, could take us one step closer towards a company law to support regenerative principles. This would ensure that directors make use of their discretion within the current law to take account of stakeholders and long-term interests in considering the business case (that is, the impact on profit and shareholder value) for corporate action.⁴⁵

But we have reasons to be sceptical so long as incentives and market pressure persist that drive directors to serve short-term financial interests. The fate of recent revisions to the UK corporate governance framework suggests that soft-law incremental change is often not powerful enough for structural and cultural reform.⁴⁶

Moreover, even a progressive interpretation would struggle to overcome the principle of shareholder value which remains the driving norm of section 172 in its current wording. A regenerative economy however requires that directors may, on some occasions, go beyond this principle while still serving the overall interest of the company, including its investors.

⁴⁴ BBC, 9 July 2019, David Attenborough: We cannot be radical enough, available at <https://www.bbc.com/news/av/uk-politics-48924188>

⁴⁵ See G. Tsagas, ‘Section 172 of the Companies Act 2006: Desperate Times Call for Soft Law Measures’ in N. Boeger and C. Villiers (eds.) *Shaping the Corporate Landscape: corporate reform and enterprise diversity* (Hart, 2018).

⁴⁶ Financial Reporting Council, *The UK Corporate Governance Code 2018*, available at <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF>

The rationale for legal change

We consider an amendment to the text of section 172 necessary, moving from the principle of shareholder value to an approach that embraces stakeholder governance and expressly provides directors with instructions to consider the company's impact on its environment and wider society.

The intention behind this revision is to energise the transition to a regenerative economy by providing a clearer and more reassuring legal framework for directors to take these principles seriously, even if to do so involves challenging decisions and consideration of financial targets as well as their impact on environmental and wider societal benefits. It is an invitation to directors to lead.

We consider three rationales that support this legal change:

1

The theoretical foundations of (enlightened) shareholder value have been rightly challenged as corporate law experts increasingly recognise that shareholders are not the sole residual claimants in operating companies. Other important corporate stakeholders, particularly employees, also make firm-specific investments in the company's continued operation.⁴⁷ Nor is the prioritisation of shareholders strictly necessary to impose managerial accountability on directors when increasingly, accounting measures and systems are available to enable other stakeholders to hold them to account.⁴⁸

2

A new understanding of corporate purpose acknowledges the responsibility of business to account to society, in return for the legal privileges and the economic and political power that companies enjoy.⁴⁹ A reform of section 172 will reflect this responsibility as quid pro quo for the legal benefit of limited liability and, more fundamentally, the 'the concentration of power in private hands' that the corporate form enables.⁵⁰

3

We should take seriously the evidence, outlined above, that operating as a profit-with-purpose business is increasingly seen as a route to success and, related, the growing support among business leaders to make this commitment a legal default by levelling the playing field for all companies. An example of this movement in the UK is the Better Business Act coalition, bringing together over 200 businesses with a mission is 'to change UK law so businesses put balancing people, profit and planet at the heart of their purpose and the responsibility of their directors.'⁵¹ To achieve this, they call for an amendment to Section 172 in line with the principle of stakeholder governance.⁵²

The Better Business Act

The Better Business Act,⁵³ put forward by a coalition of 200 business actors – including the IoD – proposes a revision to the wording of section 172 setting out a default “triple-bottom-line” purpose for all companies. The proposal has been described as ‘an evolution’ in our understanding of capitalism and its ability to solve global challenges.⁵⁴

Under a reformed regime, directors would be expected to manage the company for the benefit of its members (shareholders) while ensuring it operates in the interest of society and the environment. The revision to acknowledge “profit, people and planet” as corporate purpose would still leave directors a wide margin of discretion of how to approach these decisions, in keeping with the existing business judgment rule.

We consider an amendment to the text of section 172 necessary, moving from the principle of shareholder value to a stakeholder-oriented approach that expressly provides directors with instructions to consider the company's impact on its environment and wider society.

⁴⁷ M Blair, Firm-Specific Human Capital and Theories of the Firm, 2003, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=167848

⁴⁸ T Belinfanti and L Stout, Contested Visions: The Value of Systems Theory for Corporate Law, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2942961

⁴⁹ Bates Wells LLP, 2019, <https://bateswells.co.uk/wp-content/uploads/2019/12/UPDATED-Explanation-of-the-Companies-Act-2006.pdf>

⁵⁰ J Parkinson, Corporate Power and Responsibility (Clarendon Press, 1995), p. 30.

⁵¹ <https://betterbusinessact.org/about-the-act/>

⁵² See <https://betterbusinessact.org/about-the-act/>. Commitment to four principles of legal change: (1) Stakeholder Governed: Stakeholder governance becomes the governing principle of fiduciary duty within Section 172 of the Companies Act. (2) Empowering Directors: This change must empower directors to exercise their judgement in weighing up and advancing the interests of all stakeholders. (3) Default Change: This change must apply to all businesses by default. It must no longer be optional to benefit wider stakeholders beyond shareholders. (4) Reflected in reporting: Following this change, businesses must report on how they balance people, planet and profit in a strategic report or impact report, where one is currently required.

⁵³ See <https://betterbusinessact.org/wp-content/uploads/2021/03/The-Better-Business-Act-2021.docx.pdf>. We also note an earlier proposal by law firm Bates Wells LLP and Bill Clark (the US lawyer who is the original architect of the benefit corporation legal form in the US). See Bates Wells LLP, The Companies Act 2006 (Amendment) (Company Purpose) Bill, <https://bateswells.co.uk/companypurposebill/>

⁵⁴ <https://bateswells.co.uk/wp-content/uploads/2019/12/UPDATED-Explanation-of-the-Companies-Act-2006.pdf> referring to The Companies Act 2006 (Amendment) (Company Purpose) Bill.



The new wording of a revised section 172 would be closely modelled on the existing text, highlighting the evolutionary nature of this revision. In keeping with its overall approach to purpose, it commits directors to reducing the harm that the company's operation may inflict on wider society and the environment in a manner that is commensurate with the size of the company and the nature of its operations.

In essence, 'a large company should produce greater benefits than a smaller company. Similarly, the benefits produced by a company with largely passive operations will be very different from the benefits produced by a company with significant manufacturing operations.'⁵⁵

The wording of the proposed revision to section 172 by the Better Business Act reads as follows:⁵⁶

172 Duty to advance the purpose of the company

- (1) A director of a company must act in the way the director considers, in good faith, would be most likely to advance the purpose of the company, and in doing so must have regard (amongst other matters) to the following considerations—
- (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 well-deserved reputation for trustworthiness and high standards of business conduct, and
 - (f) the need to act fairly as between members of the company.
- (2) The purpose of a company shall be to benefit its members as a whole, whilst operating in a manner that also—
- (a) benefits wider society and the environment in a manner commensurate with the size of the company and the nature of its operations; and
 - (b) reduces harms the company creates or costs it imposes on wider society or the environment, with the goal of eliminating any such harm or costs.
- (3) A company may specify in its Articles a purpose that is more beneficial to wider society and the environment than the purpose set out in subsection (2).

⁵⁵ <https://bateswells.co.uk/wp-content/uploads/2019/12/UPDATED-Explanation-of-the-Companies-Act-2006.pdf> referring to The Companies Act 2006 (Amendment) (Company Purpose) Bill.

⁵⁶ See <https://betterbusinessact.org/wp-content/uploads/2021/03/The-Better-Business-Act-2021.docx.pdf>.

Empowering discretion and steering its limits

The Better Business Act is drafted to empower directors to pursue regenerative principles while leaving them a wide margin of discretion in their decision-making on these issues.⁵⁷ We acknowledge that this may raise questions of whether a reformed legal text might indeed go further, by prescriptively steering *how* they are expected to exercise their discretion. In fact, might the *limits* of their discretion also be strengthened to ensure environmental boundaries are protected at all cost?

In this context we may for example consider the proposals to re-define corporate purpose published recently as part of an EU-wide large academic research project on *Sustainable Market Actors for Responsible Trade*.⁵⁸ These proposals favour a more prescriptive approach that imposes detailed substantive and procedural expectations with high levels of accountability on directors.

In these proposals, a legal obligation that value for the undertaking be created *within planetary boundaries* (defined as ‘the scientifically recognised processes that regulate the stability and resilience of the Earth system within which humanity can continue to develop and thrive for generations to come’) would act as “hard” constraint on their discretion. In effect, were this approach to be adopted for UK legal reform, it would write the outer edge of the Raworth’s doughnut expressly into company law as a barrier beyond which directors may not take the company.

The question of where, in the reality of reforming the law of section 172 of the Companies Act 2006, might lie an effective and politically achievable balance between differing approaches, is a matter that will require wider political discussion as part of the legal reform process. More fundamentally, with a set of pioneering ideas and proposals for drafting revisions readily available, we believe a full and open political debate on these issues in the reform of section 172 cannot come soon enough.

With a range of pioneering proposals for drafting revisions already available, a full and open political debate on the reform of section 172 cannot come soon enough.

Company reporting

To operate effectively, a reformed regime will require adequate measures to impose accountability on directors for the execution of their revised duties, including a transparent and comprehensive reporting framework under which companies account for activities in their financial statement as well as their impact on people and planet.

It requires disclosure laws to undergo further reform to improve the quality and comparability of non-financial information which is provided both to shareholders and to stakeholders, including greater standardisation and effective monitoring and minimum sector-specific requirements.⁵⁹

In that regard, the Better Business Act proposes to align the UK corporate reporting regime with director’s revised legal duties by strengthening the strategic report, with an amendment proposed to section 414CZA of the Companies Act 2006 as follows:

414CZA Section 172(1) statement

- (1) A strategic report for a financial year of a company must include a statement (a “section 172(1) statement”) which describes how the directors when performing their duty under section 172 —
 - (a) have advanced the purpose of the company, and
 - (b) have had regard to the matters set out in section 172(1)(a) to (f).
- (2) Subsection (1) does not apply if the company qualifies as medium-sized in relation to that financial year (see sections 465 to 467).

Further-reaching reforms will be necessary to ensure the effectiveness of the reporting framework under a revised regime.

An important additional change would affect section 396 Companies Act 2006 on corporate accounting which requires a company’s accounts to ‘give a true and fair view of the state of affairs ... [and] of the profit and loss of the company.’ A revision whereby the ‘true and fair view’ would be re-defined to include information on the social and environmental impact of the enterprise would align with a wider revised framework.⁶⁰ Such a change would be consistent with the requirement for directors to show how they have complied with their duty under section 172.

⁵⁷ See also <https://betterbusinessact.org/about-the-act/>

⁵⁸ B Sjöfjell et al., Securing the Future of European Business: SMART Reform Proposals, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3595048. Section 6.2 contains the full text of the proposal to revise European Company law.

⁵⁹ European Commission initiative ‘Revision of the Non-Financial Reporting Directive’, Press release 4 February 2020, <https://www.iasplus.com/en/news/2020/02/nfrd> and European Commission, Public Consultation: Non-financial reporting by large companies (updated rules) 20 February 2020 at <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation>

⁶⁰ Social Value UK, ‘How Do Companies Act? – Accounting To Save The Planet And People’, at <http://www.socialvalueuk.org/how-do-companies-act-accounting-to-save-the-planet-and-people/>

This may also require changes for the role of auditors who would then audit the accounts against additional standards. An example can be found in the Assurance Standard published by Social Value UK in 2017⁶¹, that sets out how companies seeking social value accreditation must demonstrate that their social reports comply with the seven principles of social value for measurement purposes identified also by Social Value UK.⁶²

Standardising these approaches into the mainstream accounting and auditing processes would assist companies to produce more relevant and genuine company reports around sustainability issues. The IFRS Foundation, for example, has identified ‘an urgent need to improve the consistency and comparability in sustainability reporting’ with a set of ‘comparable and consistent standards’, to allow businesses to build public trust through greater transparency that will be helpful to investors, other stakeholders and society. To that effect, it has proposed the establishment of a Sustainability Standards Board responsible for ‘developing a framework for sustainability reporting which is coherent with and connected to financial reporting.’⁶³

This could be further supported by the planned introduction of mandatory reporting requirements based on the Task Force on Climate-related Financial Disclosures (TCFD) standards for UK listed companies. ClientEarth, in its recent report on climate change-related reporting, has proposed that these should apply as soon as possible.⁶⁴ The report also sets out further-reaching proposals for the Financial Reporting Council and Financial Conduct Authority to resource and train enforcement teams to supervise and investigate the adequacy of companies’ climate change-related reporting, and to take clear and unambiguous enforcement action where companies and their auditors omit material climate change-related information.

Corporate sustainability strategy

An obligation to develop corporate sustainability strategies at board level may be incorporated into the general obligation under section 172, set out in secondary legislation or introduced as part of a separate more specific legal regime.

In that respect, we support the recent academic statement on Corporate Governance for Sustainability which proposes that ‘directors should be subject to a legally-binding obligation to develop, disclose and implement, on behalf of the company, a forward-looking corporate sustainability strategy that identifies and addresses material environmental and social issues and significant impacts connected to the company’s business model, operations and supply chain.’⁶⁵ The statement identifies a number of important aspects that can provide a basis for discussion on introducing a substantive obligation into UK law to develop a corporate sustainability strategy.

While directors should have discretion to identify what issues are material for their company’s sustainability strategy, we agree that the law would have to clarify important compulsory requirements.

These should include a requirement to incorporate considerations that create positive societal impact into the firm’s operations generally, but potentially also a set of sector-specific objectives. These may be addressed on a ‘comply or explain’ basis, but there would need to be clarity where explanations would have to be provided and what regime would apply to unlisted (and to AIM-listed) companies.

In addition, we may consider the possibility, following a recent proposal by ClientEarth, of providing shareholders with an advisory vote at AGM on the adequacy of strategic targets generally or on specific objectives, for example on climate change strategies and targets.⁶⁶

To ensure the accountability of directors for producing an effective corporate sustainability strategy, we agree that its targets would have to be verifiable and supplemented by a commitment to making sufficient resources available to management for their implementation. An annual progress report could be included in the

⁶¹ See Social Value International, Assurance Standard, December 2017, at <http://www.socialvalueuk.org/app/uploads/2017/08/Assurance-Standard-Dec-2017.pdf>

⁶² ‘The Seven Principles of Social Value, Social Value UK’, at http://www.socialvalueuk.org/app/uploads/2016/03/Principles%20of%20Social%20Value_Pages.pdf

⁶³ IFRS Foundation, Consultation Paper on Sustainability Reporting, September 2020, <https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf>

⁶⁴ ClientEarth, Accountability Emergency: A review of UK-listed companies’ climate change-related reporting (2019-20), February 2021, <https://www.clientearth.org/media/wbglw3r3/clientearth-accountability-emergency.pdf>. See also HM Treasury, ‘UK joint regulator and government TCFD Taskforce: Interim Report and Roadmap’, 2020, <https://www.gov.uk/government/publications/uk-joint-regulator-and-government-tcf-taskforce-interim-report-and-roadmap>.

⁶⁵ A. Johnston et al., Corporate Governance for Sustainability Statement, 2020, available at: <https://corpgov.law.harvard.edu/2020/01/07/corporate-governance-for-sustainability-statement/>

⁶⁶ ClientEarth, ‘Accountability Emergency’, above fn. 64

company's non-financial report, but this would require further specification, for example whether a separate report would be required and whether publication is necessary and where.

We acknowledge that a UK-wide policy of linking remuneration of executive management to the achievement of measurable targets set in the corporate sustainability strategy would be ambitious and require further legal revision. It would involve clarifying how this correlation should be measured, which may be challenging especially for service companies (that are non-extractive, non-producing and non-manufacturing).

This may be complex, but it is needed.⁶⁷ The B Impact Assessment, which is a compulsory part of gaining B Corp certification, for example includes questions that reward companies who do tie compensation to sustainability performance.⁶⁸

Conclusion

The proposals in this White Paper outline how UK company law can be amended and refined to accelerate the transition to a distributive and regenerative economy:

- 1 By encouraging and facilitating voluntary action at company level where more and more businesses commit to a profit-with-purpose format by choice.
- 2 Going further, by campaigning for a revision in the law of section 172 of the Companies Act 2006 to ensure that profit-with purpose eventually becomes the default for all companies. An open and meaningful political discussion on legal reform cannot come soon enough, with pioneering proposals already available.

These changes are proposed against the backdrop of widespread expectations in our society that businesses should operate in accordance with profit-with-purpose principles, and wider evidence that these businesses most likely improve the position of investors in the long run too. We may anticipate resistance to change but given the urgency for action as crises, and especially the climate emergency, escalate globally, the transition to a regenerative economy has become an existential matter for business as for society. Continuing the orthodoxy of shareholder value could be devastating.

⁶⁸ <https://bimpactassessment.net/>



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The IoD Centre for Corporate Governance exists to explore current issues in corporate governance, company stewardship and ESG - for the benefit of the business community, IoD members and wider society. The Centre arises from the IoD's Royal Charter obligation to "promote the study, research and development of the law and practice of corporate governance". The Centre functions as an independent, not-for-profit centre of excellence under the umbrella of the IoD. Please note that views expressed in Centre publications do not necessarily reflect the position of the IoD or the Centre Advisory Board, and are solely the responsibility of the authors.

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