THE PURPOSEFUL COMPANY

July 2020

Response to the BEIS Committee's post-pandemic economic growth super inquiry

The Purposeful Company Steering Group

Submission context

This document sets out the response of the Steering Group of The Purposeful Company Taskforce to the BEIS Committee's post-pandemic economic growth super inquiry issued in June 2020.

Introduction to The Purposeful Company

The Purposeful Company (TPC) Taskforce was launched in 2015 with the support of the Bank of England, and is guided by a Steering Group, co-chaired by Clare Chapman, NED and remuneration committee chair at three major companies and Chair of Acas, and Will Hutton, economist, political commentator, and Principal of Hertford College, Oxford. The other members of the Steering Group are:

- Alex Edmans, Professor of Finance, London Business School
- Tom Gosling, ex-Partner at PwC and Executive Fellow at London Business School
- Colin Mayer, Professor of Management Studies, Saïd Business School

The Taskforce is a consortium of leading companies, investment houses, business schools, and business consultancy firms. Since 2015, TPC has been examining how the governance and capital markets environment in the UK could be enhanced to support the development of value generating companies, acting with purpose to the long-term benefit of all stakeholders. Our work is available on our website, and we are pleased that a number of regulatory initiatives have adopted a range of our ideas. For example, both the recent UK Corporate Governance Code and Stewardship Code have incorporated our ideas on the pivotal and necessary role of purpose.

Reason for submitting evidence

As well as commenting on research and policy, the Steering Group participants are active in the debate on governance, stewardship and pay reforms. Members of the Steering Group have variously:

- Worked actively on real-life examples of enacted reforms within leading companies
- Engaged actively with the investor community
- Published original research

The Steering Group is therefore well placed to comment on the state of play, both from the perspective of the best academic evidence and also the realities of current practice.

This report has been authored by the Steering Group. The authors are acting in their personal capacity in collaborating on this project and the views expressed here may not be taken to represent the views of their organisation. Nor does membership of the Purposeful Company Taskforce by an organisation represent an endorsement of this submission.

Responses to specific questions

Three questions are particularly apposite to our expertise and concerns, and we answer them in turn.

What core/guiding principles should the Government adopt/prioritise in its recovery package, and why?

Plainly the UK economy is at a critical juncture as it becomes apparent that the impacts of Covid-19 will be far reaching across society and over time. While Covid-19 will exacerbate long-standing economic weaknesses in our economy, it also provides an opportunity for us to build back better. Some of the central themes to doing this will be around rebuilding trust in business, improving productivity, promoting resilience and ensuring greater investment and innovation.

Company purpose is at the core of how companies can build back better. A common purpose binds together all members of an enterprise, inspiring them to go beyond simply satisfying their contractual requirements and instead to actively create value through the pursuit of excellence and innovation. Doing so grows the pie for *both* stakeholders *and* shareholders, thus enabling companies to serve wider society at the same time as remaining commercial and profitable. The TPC Taskforce's Interim Report gathered significant evidence that companies that deliver value to their material stakeholders also generate superior long-term returns to investors. The more policy can nurture purposeful companies, the more we can build back a better and more sustainable economy.

TPC have identified four purposeful commitments, as below, that we believe leading companies are already committed to and should become a minimum requirement for companies in the UK as they pursue recovery. The government has supported approaching half a million companies with the Job Retention Scheme, emergency loans and grants. We believe it is in a companies' own interest to genuinely embrace purpose, and that the government could use this as an opportunity to persuade more companies to seriously consider embracing purpose. We see the following actions as key:

1. Defining and embedding purpose into the business

Today, companies are expected to play a role in making the world a better place. It is not enough to just do charitable work and to 'do no harm' (e.g. not mistreat employees). Society expects more than this. Instead companies should seek actively to do good by creating value for wider society, not just investors.

This is achieved through an uncompromising commitment to a purpose that consists of addressing two dimensions: *who* a company exists for, and *how* it aims to serve them. Having a clear purpose provides a unifying narrative for stakeholders, and guides company decision-making so that trade-offs and priorities are determined in a way that serves society rather than just investors - with investors remaining an important member of society. In many companies, profit is the end goal and actions are only taken if they generate profit. In a purposeful company, creating value for society is the end goal. It will take many actions consistent with being a sustainable business, with higher profits manifesting as a by-product. The FRC's Guidance on the Strategic Report, argues that purpose forms the lynchpin for a company's narrative. In the guidance it says, "A *company's purpose, strategy, objectives and business model are inter-related concepts…and when disclosed together* *should explain what a company does and how and why it does it".*

The World Economic Forum also argues the centrality of purpose through their statement which reflects just how far thinking has evolved in leading companies, institutional investors and amongst governments and regulators outside the U.K.:

"The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large. The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company".

The focus on ESG and stakeholder governance has shifted the question of whether a board of directors should take into account the interests of stakeholders other than shareholders, to how a board should do so. Directors need to grapple with a host of questions about the practical implications of this new paradigm, such as adjusting existing board functioning to reflect stakeholder governance, defining corporate "purpose" and shaping its "culture," integrating ESG considerations into long-term business strategy and measuring and delivering sustainable value to all stakeholders.

Purpose must not only be clearly defined; it must also be put into practice. This involves deciding on the relevant metrics to measure whether the company is delivering on its purpose, setting targets, and committing to report on progress relative to targets. Given that appropriate metrics will vary between companies, depending on their purpose, the government should avoid being prescriptive on a particular set. Despite the value of metrics, companies should be mindful not to focus on them excessively as they can only capture quantitative factors – e.g. demographic diversity rather than diversity of thinking and a culture that encourages debate and participation. Companies should ensure they are also gauging these qualitative dimensions.

Other ways to embed purpose throughout the organisation are to ensure that board discussions are centred around purpose, it is designed into a company's operating model, that culture is aligned with purpose, and that the company engages in regular discussions with its investors and material stakeholders on purpose.

A small number of companies have gone further than defining and embedding their purpose by writing it into their articles of association. Examples include Danone in France (whose purpose is to bring health through food to as many people as possible) and Anglian Water in the UK (whose purpose is to bring environmental and social prosperity to the region they serve through Love Every Drop.) While appropriate for some companies, it may prevent flexibility of purpose in others. It should not be considered a gold standard that every firm should aspire to and we would encourage a plurality of approaches from companies to find the best approach for them.

Companies can use purpose to tell their unique story, explain the value that they create for society, evidence the actions taken, and outline how purpose has guided behaviours and decision-making. This latter aspect is crucial. A company can have a good purpose and a strategy that follows from it and yet still have exploitative relationships with some stakeholders. Embracing purpose fully implies a commitment to having a positive impact over the long-term on all those on whom the business relies for its success.

We recommend that all recipients of government support should commit to declare their core purpose in line with the FRC's recommendations – explaining what the company does, and how it does it – and commits to holding themselves regularly to account for the delivery of the declared purpose.

2. Purpose implementation and impact should be evident through transparency

A particularly meaningful way through which companies can allow themselves to be accountable for the delivery of purpose is through giving shareholders an advisory "say on purpose" vote, analogous to the current "say on pay" vote. Indeed, given that a company's purpose is arguably even more important than its executive pay structure, it is even more important that shareholders monitor and engage on it. The value of "say on purpose" extends far beyond the actual vote to the process that shareholders need to undertake in order to decide how to vote. Doing so requires them to monitor a company's performance beyond short-term profits, and to engage in regular dialogue with companies. It will broaden the conversation between investors and companies from short-term profits to long-term stakeholder value.

The UK Corporate Governance Code highlights that Boards should understand the views of the company's key stakeholders, outside of shareholders, and describe in the Annual Report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making. Thus, a company should also decide which stakeholders are material to seek feedback from on their delivery of purpose, and the best format through which to obtain this feedback.

3. Acknowledgement of the increased societal call for justice

Covid-19 has accelerated the evolution of how society defines justice and fairness. And as companies are having to take more significant roles and responsibilities in society, their actions are being heavily scrutinised as expectations continue to rise.

As part of this scrutiny, companies are having to demonstrate that the burden, or reward, is being shared collectively to the extent possible – from the CEO to the most junior employee – and that they are putting in place appropriate mechanisms of transparency and legitimation. While we recognise that the commercial realities of the post-coronavirus world will require some companies to permanently downsize, and so the burden cannot always be equally shared, a purposeful company will – to the extent commercially possible – mitigate the losses of those bearing a disproportionate burden. For example, Airbnb is downsizing as the coronavirus has permanently shrunk the importance of the travel sector for society. It is providing all employees with a minimum of 14 weeks' severance pay (significantly greater than the statutory minimum) and guaranteeing their health insurance for an additional year.

We also recommend that remuneration committees recast executive pay so that executives are paid in restricted stock that must be held for several years, to ensure that executives are aligned with long-term value. To the extent that annual bonuses are given, they should be based on a balanced scorecard of relevant metrics that include the delivery of purpose, rather than only financial performance. We also recommend that companies be required to publish a Fairness Report, as noted in TPC's Report 'Strengthening Board Accountability for Alignment of Wider Pay Policy - Demonstrating fairness, building trust'.

4. Deploying purpose for a more resilient and productive future

Covid-19 has brought unprecedented challenge, change and disruption, but one thing is certain, we will not be returning to our previous normal. Companies need to look to the future and understand what their business needs to do to recover. We believe being guided by purpose will help companies to be more resilient - whether this involves investing in new products and services, reinventing workplaces for employees, finding ways to improve productivity or developing new social contracts at work. Companies should use their purpose to bring their greatest strengths to bear as they reimagine and re-deploy their resources in the post-Covid-19 world.

In addition to the above, we believe the government should consider the following points:

Protecting strategic assets

The lens of purpose is a key prism through which to assess whether, if UK assets fall into foreign ownership, the fulfilment of strategic purpose is likely to be weakened or reduced in any way. We suggest that the government has an informal hierarchy of purpose, and a comparable scale of requirements from foreign buyers to meet that purpose, which at the limit will include forbidding the acquisition.

Strategic skills: workforce and labour

Modelling on the future of work suggests that by 2030 up to 30 to 40 percent of all workers in developed countries may need to move into new occupations or at least upgrade their skill sets significantly. Research also suggests that skilled workers that are already in short supply (for example telco engineers) will become even scarcer. Some major organisations are already treating this as a sustainability issue. BT has invested significantly in attracting young people and women into STEM subjects and Amazon has recently pledged $700m to retrain 100,000 employees for higher-skilled jobs in technology (for example training warehouse employees to become basic data analysts). As a country we need to be out in front on this issue and companies should be given incentives to invest in strategic workforce initiatives. The pace and scale of disruption – accelerated in some cases by Covid-19, with its risks of unemployment and growing income inequality – are as much a societal and political challenge as a business one.

Investing in innovation and place

Innovation is driven by an impulse to deliver whatever goods or services, better – in other words to deliver purpose better. The government is keen to establish growth hubs in all parts of the UK to level-up opportunity. Growth hubs will work better the more that companies associated with the hub – as start-ups and scale-ups – are committed to a purpose that will propel their innovative capacity.

How can the Government borrow and/or invest to help the UK deliver on these principles?

Following on from our first answer we urge the government to enshrine these principles in its own investment programme – to declare the purpose in whatever it proposes and hold itself to account for its delivery, just as companies are required to do under the UK Corporate Governance Code and Strategic Report Guidelines. Green investment, for example, should be accompanied by clear statements of the expected environmental gains, which should be published transparently as projects go forward.

What role might Government play as a shareholder or investor in businesses post-pandemic and how this should be governed, actioned and held to account?

The government has announced Project Birch in which it will offer debt and, as a last resort, equity investment in distressed companies. It is also known to be considering launching an institution analogous to the Industrial and Commercial Finance Corporation (ICFC) which became 3i. We recommend that the government insists that as a minimum that any companies who receives any investment or bail-out, that the recipient companies declare their purpose – and hold themselves to account for its delivery - as we recommend in our first answer.

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www.biginnovationcentre-purposeful-company.com | tpc@biginnovationcentre.com