

Social Enterprise UK

Social Enterprise UK (SEUK) was established in 2002 as the national body for social enterprise in the UK. A social enterprise is a business that trades for a social or environmental purpose and reinvests its profits in that mission.

Social enterprises are businesses driven by social or environmental objectives, whose surpluses are reinvested for that purpose in the business or in the community. They operate across a wide range of industries and sectors from health and social care, to renewable energy, recycling and fair trade and at all scales, from small businesses to large international companies.

They take a range of organisational forms from co-operatives and mutuals, to employee owned structures, Community Interest Companies, and charitable models. SEUK's members come from across the social enterprise movement, from local grassroots organisations to multimillion pound businesses that operate across the UK.

SEUK is a membership organisation. We conduct research; develop policy; campaign; build networks; support individual social enterprises; share knowledge and understanding; support private business to become more socially enterprising; and raise awareness of social enterprise and what it can achieve.

We welcome the opportunity to respond the Government's Green Paper on Corporate Governance.

Summary of recommendations

4. Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

We support mandatory reporting of pay ratio reporting in annual reports for PLCs based on the median and top pay and the ratio of bottom to top pay using a universal methodology.

7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

There is a widespread, cross-sector support for the creation of mechanisms for businesses to demonstrate their commitment to transparency on tax, pay ratios, diverse boards, and social and environmental impact. The most obvious route is through a strengthened of narrative reporting, based on the progress made in recent years.

We recommend that Government also needs to make progress to allow institutional investors to fully take into account social and environmental considerations.

Government to lead a longer-term debate on the best model for corporate governance.

Government to start a debate on whether section 172 of the Companies Act could be strengthened.

Government to institute a Right to Observe where companies hold public sector contracts over a threshold.

Of the options proposed in the Green Paper, we support option (i) Create stakeholder advisory panels, option (iii) Appoint individual stakeholder representatives to company boards and option (iv): Strengthening reporting requirements related to stakeholder engagement - whilst recognising that they are a poor alternative to real change.

10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

We propose that Government invites the FRC to develop a voluntary code based on current best practice.

We propose that the (newly strengthened) UK's Corporate Governance Code applies (or can be applied) in four exception circumstances.

14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

Government is right to address the current corporate governance structure, but it also needs make the most of its own existing powers to positively shape the market, and pursue measures to promote ethical investment.

The Inclusive Economy Unit, the part of Government which understands what inclusive growth means, needs to be moved from the Office for Civil Society in DCMS to BEIS.

Substantive response

14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

Few BHS pension holders, Sports Direct staff, or workers sacked by text would concur with the panegyric to the UK's corporate governance framework in the Green Paper's introduction. There is an almost tangible sense that we have reached a watershed moment: reform of corporate governance is not only desirable it is necessary if the UK is to retain its preeminent status as the most desirable place to headquarter a business.

Far too often regulation has been seen as a drag anchor on growth. It is now widely accepted that effective regulation (i.e. more regulation in some areas, less in others) is a driver for inclusive growth and the Government's role should not be to remove 'regulatory barriers' but to design effective and enabling regulation.

Corporate Governance is only one part of the jigsaw which makes up responsible business. Government needs not only to improve the corporate governance framework, but also enable investors to fully take into account companies' behaviour, and make full use of its existing powers to ensure that those companies who it chooses to do business with are upstanding members of the business community¹. The UK lags behind other countries not just in its corporate governance framework but also in pension fund-holders' ability to take into account, for instance, ethical investment because of the myopic interpretation of fund-holders' fiduciary duty; whilst other countries fund-holders are divesting in unethical areas, fund-holders in the UK are hamstrung by out of date notions of value. Government can enable companies in the right direction; institutional investors can encourage good behaviour given the powers to do so.

Corporate Governance reform and the Industrial Strategy are rightly presented as part of the Government's policy reset under a new Prime Minister. They are symbolic of a subtle but real change in direction and emphasis. Nevertheless, wider civil society will continue to be sceptical about the importance of 'an economy that works for all' so long as the one bit of Government charged with delivering inclusive growth, the Inclusive Economy Unit, is in the Office for Civil Society, which is the Department for Culture Media and Sport (DCMS), i.e. three tiers down and distant from the Department for Business Energy and Industrial Society (BEIS). What is clear from reading the Industrial Strategy Green Paper is that civil servants in BEIS don't quite grasp what the Prime Minister is driving at; moving the Inclusive Economy Unit from DCMS to BEIS would move understanding and knowledge of more social forms of business into the Business Department and help deliver the Prime Minister's stated aspirations.

Recommendations:

- Government is right to address the current corporate governance structure, but it also needs to make the most of its own existing powers to positively shape the market, and pursue measures to promote ethical investment.

¹ See [Shadow State](#) and PPNs on taking into account past performance and tax

- The Inclusive Economy Unit, the part of Government which understands what inclusive growth means, needs to be moved from the Office for Civil Society in DCMS to BEIS.

Executive Pay

4. Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

Social Enterprise UK strongly supports mandatory reporting of pay ratio reporting in annual reports for PLCs.

We include an overview of pay ratios of social enterprises in our biennial survey of the movement, the State of Social Enterprise;² the average pay ratio between social enterprise CEO pay and the lowest paid is 3.6:1. Doubtless there is considerable variation within the movement, yet the measure is an uncontroversial one for social enterprises.

Executive pay is subject to often misleading interpretations and inappropriate comparisons; we do not accept that introducing mandatory reporting of pay ratios will exacerbate the situation based on our own experience. Indeed, we expect that the reverse will happen and very quickly industry norms will be established against which outliers can be judged by their shareholders and wider society.

We recognise that there may be some debate as to how the ratio is calculated given the complexity of senior pay packages, and we endorse the suggestion that the median and top pay and the ratio of bottom to top pay using a universal methodology should be adopted to provide clarity.

We note that an executive comparison with median pay is an approach the Securities and Exchange Commission in the USA endorses³ and think that the UK can do better.

Recommendations:

- We support mandatory reporting of pay ratio reporting in annual reports for PLCs based on the median and top pay and the ratio of bottom to top pay using a universal methodology.

Strengthening the employee, customer and wider stakeholder voice

7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

² http://socialenterprise.org.uk/public/uploads/editor/SEUK_StateofSocialEnterprise_FINAL_WEB.pdf

³ <https://www.wsi.com/articles/sec-unveils-executive-pay-ratio-guidelines-1476987334>

8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

Social Enterprise UK, and an increasing number of our members, publish a social and environment impact reports which allows stakeholders to judge non-financial impact and actions.

HCT Group, a social enterprise which turned over £44,190,000 in 2015/16, produce what many consider to be a paragon of social impact reporting. Their 2016 impact report⁴ is accessible, accountable, verifiable and proportional to their business. Many corporates could learn from their example.

We anticipate that social impact reporting will become standard in the coming years for all organisations.

However, we do not yet think that social impact should be mandatory for corporates. Rather, we believe that social impact reporting sets the telos: the direction of travel is clear and regulation should set business on the right route. To this end, Social Enterprise UK **strongly supports the strengthening of narrative reporting** to facilitate publication of a fair work policy covering job security, working conditions and hourly wages for employees and supply chain workers. The abolition of the Operating and Financial Review was a misplaced attempt at corporate deregulation.

Subsequent changes to reporting have recognised the harm done and have begun to roll back some of the damage; the introduction of the strategic report was a positive but limited measure. There is widespread, cross-sector support for the creation of mechanisms for businesses to demonstrate their commitment to transparency on tax, pay ratios, diverse boards, and social and environmental impact.

As the Green Paper notes many businesses “*have paid particular attention to nurturing supply chains*”.⁵ How does Government know this? The FRC advises: “*Complementary information that is not required to be included in the annual report (i.e. it is voluntary), but which the directors wish to place in the public domain, should generally be published separately (e.g. on the company website). The directors may, however, sometimes consider it appropriate to include some of this complementary information in the annual report. In such cases, that information could be included either in a separate, non-statutory section of the annual report or in the directors’ report.*”⁶

Shouldn't the Government and the FRC encourage companies to tell their wider stakeholders what they have achieved in their strategic report, not least so that when Government makes bold statements about business these statements are based on verifiable information?

The correct approach is a mixture of legislation and non-binding guidance, i.e. broadly what we have now, but with more of a steer towards greater transparency. Legislation should set

⁴ <http://hctgroup.org/uploaded/hct-group-impact-report-2016.pdf>

⁵ Green Paper p36

⁶ <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf> para 3.18

what non-financial reporting needs to be done, and FCA guidance explains how this could be achieved. This leaves some flexibility and room for innovative approaches which will ultimately lead to better outcomes.

It is worth reprising why this is so important. Social Enterprise UK believes that transparency is key to good corporate governance and behaviour. Individual investor decisions and shareholder action by groups can be a genuinely effective driver for better corporate governance - but transparency in the form of narrative reporting is a prerequisite to this. In the absence of effective narrative reporting, investors are faced with an imperfect investment market. Transparency helps the market work more effectively.

Of course, individual decisions have limited effective compared to institutional fund-holders. We note that UK institutions seem to be lagging behind their international counterparts in this respect⁷, limited by UK law. The Law Commission's 2014 report *Fiduciary Duties of Investment Intermediaries*⁸ examined the law which is clearly insufficient in respect of fully taking into account social and environmental considerations, and they are currently exploring the possibility of pension funds and social investment.⁹ Further work on this by Government is essential.

Within the social enterprise movement, it is common to find a variety of structures and a strong stakeholder voice. The following 3 examples give some indication of the variety:

CSH Health, is an award winning community healthcare provider where strong partnerships – inside and out – and motivated co-owners drive the delivery of better care. It has a workers' council called the Voice, whose co-owner elected representatives ensure co-owners' voices are heard at Board level.¹⁰

Leading Lives an employee owned co-operative and social enterprise. Staff have the opportunity to become members of our employee owned co-operative and the business is run by an elected Board of staff members who run the business on behalf of all the members.¹¹

Social Adventures is a wellbeing social enterprise specialising in public health and social care contracts that run alongside social businesses – such as garden centres, community cafes and, childcare nurseries. It is 50% owned by service users and 50% owned by employees.

Mutuals, cooperatives and social enterprises seem to be able to manage multi-stakeholder board models. Indeed, there are enduring and powerful examples of how successful these models are in the UK. However, we recognise the practical difficulties of incorporating wider stakeholder input with the UK's current system of unitary boards and would welcome a debate on whether unitary boards are the most appropriate vehicle for corporate governance in the long-term; the Green Paper is a missed opportunity in this respect.

Social Enterprise UK has argued previously for a Right to Observe the Board for users of a public service provider, and a in lieu of significant reform to the unitary board system - this may provide a solution for employees and customers in limited circumstances. Here at least, there is a clear contractual lever, and a public policy rationale for this.

⁷ <https://www.theguardian.com/environment/2015/sep/22/leonardo-dicaprio-joins-26tn-fossil-fuel-divestment-movement>

⁸ <http://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/>

⁹ <http://www.lawcom.gov.uk/project/pension-funds-and-social-investment/>

¹⁰ <https://www.cshsurrey.co.uk/about-us/about-csh-surrey/co-ownership>

¹¹ <http://www.leadinglives.org.uk/about-us/why-choose-us>

We also think section 172 of the Companies Act could be strengthened. Directors have a duty “to promote the success of the company for the benefit of its members as a whole.” In reality, it is widely recognised that stakeholder obligations go much wider than this, and we appreciate that providing a functional legal definition would be tricky. Nevertheless, we would welcome a debate on this – perhaps extending the duty to potential investors might be worth exploring.

Further, we endorse support for wider company ownership. We have previously proposed¹² a fiscally neutral swap of tax incentives, abolishing support for executive share bonuses and channelling that money to support employee buyouts which would support wider employee voice.

Richard Fuller MP made an important intervention when the Secretary of State launched the Green Paper when he said that the most egregious abuses have come about where the largest shareholder also appoints themselves to chief executive position¹³: one might say this produces the worst possible blend of private equity and public ownership without the benefits of either (except, perhaps, for the largest shareholder). It is not clear how the Government thinks this apparent flaw in the system will be resolved.

Recommendations:

- There is a widespread, cross-sector support for the creation of mechanisms for businesses to demonstrate their commitment to transparency on tax, pay ratios, diverse boards, and social and environmental impact. The most obvious route is through a strengthened of narrative reporting, based on the progress made in recent years.
- We recommend that Government also needs to make progress to allow institutional investors to fully take into account social and environmental considerationsGovernment to lead a longer-term debate on the best model for corporate governance.
- Government to start a debate on whether section 172 of the Companies Act could be strengthened.
- Government to institute a Right to Observe where companies hold public sector contracts over a threshold.
- Of the options proposed in the Green Paper, we support option (i) Create stakeholder advisory panels, option (iii) Appoint individual stakeholder representatives to company boards and option (iv): Strengthening reporting requirements related to stakeholder engagement - whilst recognising that they are a poor alternative to real change.

¹² http://socialenterprise.org.uk/uploads/editor/files/Social_Enterprise_UK_Budget_submission_final_2017.pdf

¹³ <https://hansard.parliament.uk/commons/2016-11-29/debates/E9D1F9A6-346E-4C78-8885-9A51037A80BE/CorporateGovernance>

10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

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12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

The advantage private companies have is that they can be bold and are not restrained by transparency; the downside of private companies is that they can be bold and are not restrained by transparency.

Social Enterprise UK appreciates that Government's instinct is to not intervene in private (i.e. non listed companies) business; the difficult part is identifying where there may be strong public policy reasons to intervene. We suspect there may be some circumstances where this is the case, particularly where there have been rapid changes to the nature of the economy. Market pre-eminence, influence and importance are the important factors, not legal form (or size threshold) – though we recognise these are easier to determine.

However, we note that the best privately owned businesses have strong corporate governance frameworks and in some cases have an ethical approach to doing businesses which meets or exceeds listed companies. The challenge is to encourage the best of those traditions in the behaviours and cultures of today's companies where they not currently exist.

In the first instance we recommend Government promulgate best practice, drawing on existing examples of private-held business in a light-touch attempt to foster best practice.

We make four exceptions where we believe stronger corporate governance for private-held business needs to be placed on a statutory footing. In each of the following scenarios there is a pressing public policy case for statutory corporate governance standards:

Where private equity buys a listed company resulting in delisting.

Admittedly rare but in such cases a company, perhaps employing thousands of people, will go from statutory reporting to being under no obligation to report overnight. It may be prudent to have some tapering off of statutory requirements into a voluntary code.

Where the takeover is a leveraged buy out (LBO) of a high profile company

LBOs, especially when the company is a high profile one like a football club exercise the public more than other buy outs. Where there is a LBO of a major or high profile company, the public perception is that somewhere along the line they will be ripped off. We recognise that definition of an LBO and 'high profile' private company may

present problems, but we are assured that if given appropriate powers, Ministers would know a high profile LBO of a private company when they see one. Statutory reporting – perhaps time limited – would give some reassurance to the public.

Where the privately-held company holds significant public sector contracts.

Social Enterprise UK has consistently pressed the Government for greater transparency over private sector delivery of public services; where an organisation holds contracts with government above a reasonable threshold, statutory reporting should be introduced for the duration of the contract.

Where a fast growing private-held company comes to hold a pre-eminent position in a market.

Technology has changed everything: private-held companies can rise to prominence within particular markets very quickly and the public view is that they are unaccountable to the public, and beyond the reach of HMRC. There are few currently existing policy levers and the bar seems to be set high for the main intervention, a Competition and Markets Authority investigation. Since most tech-based companies do seem ultimately to transition to public ownership, requiring statutory report at an early stage is likely to make that transition easier as well as giving the public a greater level of reassurance about the business' activities.

In most of these cases most privately-held businesses probably do already meet, or come close, to statutory reporting.

Recommendations:

- We therefore propose that Government invites the FRC to develop a voluntary code based on current best practice. This would be relevant to the vast majority of large privately-held businesses.
- We also propose that the (newly strengthened) UK's Corporate Governance Code applies to privately-held businesses in the four exceptional instances mentioned.

For more information

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